Office-Supreme Court, U.S.
FILED
JUN 15 1984
ALEXANDER L. STEVAS,
CLERK

83-2064
No. --

In the Supreme Court of the United States

OCTOBER TERM, 1983

T. H. BELL, SECRETARY OF EDUCATION, PETITIONER

v.

STATE OF NEW JERSEY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REX E. LEE
Solicitor General
RICHARD K. WILLARD
Acting Assistant Attorney General
KENNETH S. GELLER
Deputy Solicitor General
HARRIET S. SHAPIRO
Assistant to the Solicitor General
AL J. DANIEL, JR.
Attorney
Department of Justice
Washington, D.C. 20530
(202) 633-2217

86 pp

BEST AVAILABLE COPY

QUESTION PRESENTED

Whether subsequent amendments in substantive requirements of federal grants should be applied retroactively to audits of previously expended grant funds in the absence of any legislative direction to that effect.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statutes and regulation involved	2
Statement	3
Reasons for granting the petition	6
Conclusion	17
Appendix A	1a
Appendix B	6a
Appendix C	32a
Appendix D	59a
Appendix E	60a
Appendix F	62a

TABLE OF AUTHORITIES

Cases:

Bell v. *New Jersey*, No. 81-2125 (May 31, 1983) 3, 6, 7, 8, 14
Bradley v. *School Board*, 416 U.S. 696 ..... 5, 6, 11, 12, 13, 14
Cameron v. *United States*, 231 U.S. 710 ... 8
Claridge Apartments Co. v. *Commissioner*, 323 U.S. 141 8
Connett v. *Jerseyville*, 96 F.2d 392 12
Cort v. *Ash*, 422 U.S. 66 12
Employees v. *Missouri Pub. Health Dep't*, 411 U.S. 279 12
Funkhouser v. *Preston Co.*, 290 U.S. 163 .. 12
Greene v. *United States*, 376 U.S. 149 8
Gulf Offshore Co. v. *Mobil Oil Corp.*, 453 U.S. 473 12

Cases—Continued: Page

Hertz v. *Woodman*, 218 U.S. 205 11
Hutto v. *Finney*, 437 U.S. 678..... 12
Indiana v. *Bell*, 728 F.2d 938 7
Kentucky v. *Secretary of Education*, 717 F.2d 943, petition for cert. pending, No. 83-1798 7
King v. *Smith*, 392 U.S. 309 7
Koger v. *Ball*, 497 F.2d 702 12
LTV Federal Credit Union v. *UMIC Government Securities*, 704 F.2d 199 10
McGee v. *International Life Ins. Co.*, 355 U.S. 220 13
NLRB v. *National Garment Co.*, 166 F.2d 233 11
North Carolina Comm'n of Indian Affairs v. *Dep't of Labor*, 725 F.2d 238 7
Oklahoma v. *Civil Service Comm'n*, 330 U.S. 127 14
Pennhurst State School & Hospital v. *Halderman*, 451 U.S. 1 ..... 7, 16
Sikora v. *American Can Co.*, 622 F.2d 1116 ..... 10, 14
Silverlight v. *Huggins*, 488 F.2d 107 12
Tcherpnin v. *Knight*, 389 U.S. 332 13
Union Pacific R.R. v. *Laramie Stock Yards Co.*, 231 U.S. 190..... 9, 10
United States v. *Carter*, 171 F.2d 530 11
United States v. *Heth*, 7 U.S. (3 Cranch) 339 8
United States v. *Magnolia Petroleum Co.*, 276 U.S. 160 8

Cases—Continued: Page

United States v. *Mechem*, 509 F.2d 1193... 11
United States v. *Security Industrial Bank*, 459 U.S. 70 ..... 8, 12
United States v. *The Schooner Peggy*, 5 U.S. (1 Cranch) 103 14
Warden v. *Marrero*, 417 U.S. 653..... 11
West Virginia v. *Secretary of Education*, 667 F.2d 417 7
Winfree v. *Northern Pac. Ry.*, 227 U.S. 296 13
Woods v. *United States*, 724 F.2d 1444 7

Statutes and regulations:

Elementary and Secondary Education Act of 1965, Tit. 1, 20 U.S.C. (1976 ed.) 241a *et seq.* 3
20 U.S.C. (1976 ed.) 241e(a) 2
20 U.S.C. (1976 ed.) 241f(a)(1) 3-4
Education Amendments of 1978, Tit. 1, 20 U.S.C. 2701 *et seq.*:
20 U.S.C. 2702 9
20 U.S.C. 2732(a)(1) 2, 5, 9, 15
Education Consolidation and Improvement Act of 1981, Pub. L. No. 97-35, 95 Stat. 464, 20 U.S.C. 3801 *et seq.* 15, 16
Pub. L. No. 95-561, § 1530, 92 Stat. 2380 .. 9
1 U.S.C. 109 10
34 C.F.R. 200.56 15
45 C.F.R. (1972):
Section 116.17(d) 2, 3, 4
Section 116.54 15

Miscellaneous: Page

127 Cong. Rec. S5429 (daily ed. May 21, 1981) 10

H.R. Rep. 95-1137, 95th Cong., 2d Sess. (1978) 10

S. Rep. 95-856, 95th Cong., 2d Sess. (1978). 10

Smead, *The Rule Against Retroactive Legislation: A Basic Principle of Jurisprudence*, 20 Minn. L. Rev. 775 (1936) ... 8-9

In the Supreme Court of the United States

OCTOBER TERM, 1983

No.

T. H. BELL, SECRETARY OF EDUCATION, PETITIONER

v.

STATE OF NEW JERSEY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of T. H. Bell, Secretary of Education, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. *infra*, 1a-5a) is reported at 724 F.2d 34. The prior opinion of the court of appeals (App. *infra*, 6a-31a) is reported at 662 F.2d 208. The decision of the Education Appeal Board (App. *infra*, 32a-58a) is unreported.

JURISDICTION

The judgment of the court of appeals (App. *infra*, 60a-61a) was entered on December 27, 1983, and a petition for rehearing was denied on February 17, 1984 (App. *infra*, 62a). On May 3, 1984, Justice Brennan extended the time for filing a petition for a writ of certiorari to and including June 16, 1984. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES AND REGULATION INVOLVED

20 U.S.C. (1976 ed.) 241e(a) provided in pertinent part:

> A local educational agency may receive a grant under this subchapter for any fiscal year only upon application therefor approved by the appropriate State educational agency, upon its determination (consistent with such basic criteria as the Commissioner may establish)—
>
> (1) that payments under this subchapter will be used for * ** programs and projects * * * (A) which are designed to meet the special educational needs of educationally deprived children in school attendance areas having high concentrations of children from low-income families * * *.

20 U.S.C. 2732(a)(1) provides in pertinent part:

> [A] local educational agency shall use funds received under this subchapter in school attendance areas having high concentrations of children from low-income families (hereinafter referred to as "eligible school attendance areas") * * *. A local educational agency may designate any school attendance area in which at least 25 per centum of the children are from low-income families as an eligible school attendance area if the aggregate amount expended under this subschapter and under a State program meeting the requirements of section 2751(c) of this title in that fiscal year in each school attendance area of that agency in which projects assisted under this subchapter were carried out in the preceding fiscal year equals or exceeds the amount expended from those sources in that area in such preceding fiscal year.

45 C.F.R. 116.17(d) (1972) provided in pertinent part:

> A school attendance area for either a public elementary or a public secondary school may be designated as a project area if the estimated percentage of children from low-income families residing in that attendance area is as high as the percentage of such children residing in the whole of the school district, or if the estimated number of children from low-income families residing in that attendance area is as large as the average number of such children residing in the several school attendance areas in the school district.

STATEMENT

The statutory and factual background of this case is summarized in *Bell* v. *New Jersey*, No. 81-2125 (May 31, 1983), slip op. 1-3. In brief, federal auditors determined that respondent misused funds it had received as grants in 1970-1972 under Title I of the Elementary and Secondary Education Act of 1965 (ESEA), 20 U.S.C. (1976 ed.) 241a *et seq.*, to improve the educational opportunities available to disadvantaged children.[1] The funds were provided to finance programs "which contribute particularly to meeting the special educational needs of educationally deprived children" in areas with high concentrations of children from low-income families (20 U.S.C. (1976 ed.) 241a). The Secretary's implementing regulations established that a school attendance area met the statutory eligibility requirement if the percentage of low-income children in the area was at least as high as the percentage of such children in the entire school district (45 C.F.R. 116.17(d) (1972)). Respondent gave its assurances, as a condition of its receipt of the grant funds, that the funds would be spent only for programs and projects that satisfied all the applicable Title I requirements (20 U.S.C. (1976 ed.)

---

[1] As the Court explained (slip op. 1-2): "Local educational agencies obtain federal [Title I] grants through state educational agencies, which in turn obtain grants from the Department of Education upon providing assurances to the Secretary that the local educational agencies will spend the funds only on qualifying programs. § 182(a), 20 U.S.C. § 2734 (1976 ed. Supp. V)" (footnotes omitted).

241f(a)(1)). The federal audit revealed that, despite these assurances, more than $1 million of Title I funds had been expended in school attendance areas in Newark between September 1, 1970 and September 1, 1972, where the percentages of low-income children were below the district-wide percentage of such children, in clear violation of 45 C.F.R. 116.17(d) (1972).

After administrative review of these audit findings, the Education Appeal Board concluded that the Title I funds had been used in ineligible school attendance areas in Newark, and directed New Jersey to repay $1,031,304 to the Department of Education (App., *infra*, 57a-58a). The Secretary declined to review the Appeal Board's decision, which accordingly became final (*id.* at 15a).

Respondent thereupon petitioned for judicial review, challenging both the Secretary's jurisdiction to require recoupment and the validity of the administrative determination that the funds had been misspent. The court of appeals agreed with respondent's jurisdictional argument and therefore did not consider the alternative claim (App., *infra*, 8a). This Court reversed, "conclud[ing] that the Secretary has followed the proper procedures. He has administratively determined the amount of the debt owed by [respondent] to the Federal Government * * * as he is empowered to do" (slip op. 18-19). The Court remanded the case to the court of appeals for consideration of the State's objections to the merits of the Secretary's determination (*id.* at 19).

On remand, the court of appeals again refused to require the repayment of the funds in issue. For the first time,[2] respondent argued that its compliance with the

[2] Although the court of appeals acknowledged that appellate courts do not generally consider issues that have not been passed on by the agency or court whose decision is under review, it concluded that an exception to this rule was appropriate here because it believed the issue to be one "of national importance, which is singularly within the competence of appellate courts and is not predicated on complex factual determinations" (App., *infra*, 3a-4a n.1).

conditions attached to its Title I grant should be tested by the standards contained in the 1978 Amendments to the ESEA, rather than by the standards that were in effect when the funds were awarded and expended. The amended standards permitted the use of Title I funds in any school attendance area "in which at least 25 per centum of the children are from low-income families * * * if the aggregate amount expended under [Title I] and under a [qualifying] State program * * * in that fiscal year in each school attendance area of that agency in which [Title I] projects * * * were carried out in the preceding fiscal year equals or exceeds the amount expended from those sources in that area in [the] preceding fiscal year" (20 U.S.C. 2732(a)(1)). Respondent asserted that, if tested by this more lenient standard, most of the 1970-1972 Newark expenditures were allowable.

The court of appeals agreed that the eligibility standards contained in the 1978 Amendments should be applied to the 1970-1972 grant fund expenditures, on the theory that "[a] federal court or administrative agency must 'apply the law in effect at the time it renders its decision, unless doing so would result in manifest injustice or there is statutory direction or legislative history to the contrary'" (App., *infra*, 4a, quoting *Bradley* v. *School Board*, 416 U.S. 696, 711 (1974)). Finding no such manifest injustice or contrary statutory indication, the court concluded that retroactive application of the 1978 standards was appropriate, particularly because those amendments were assertedly "remedial," and the case "involves a public matter of great national concern [rather than] the routine private lawsuit in which a retrospective application of a law would disadvantage a private party who had relied on a settled body of pri-

vate law" (App., *infra*, 4a-5a). The court accordingly remanded the case to the Secretary to determine, for each school attendance area that had a Title I project in the relevant years, whether the 1970-1972 expenditures conformed to the 1978 standards.

REASONS FOR GRANTING THE PETITION

Last Term, this Court in this case "established the right of the Federal Government to recover funds misused by the States" when they receive Title I grants. *Bell* v. *New Jersey*, slip op. 17. The decision of the court of appeals on remand, denying such recovery when subsequent legislation has modified the standard with which a state failed to comply, substantially eviscerates the Secretary's right to recover misspent funds and seriously jeopardizes the federal government's ability adequately to monitor grants-in-aid for compliance with statutory and regulatory requirements. Moreover, the decision below is inconsistent with the decisions of other courts of appeals and with basic principles of statutory interpretation and federal grant law, and misreads both the congressional intent in enacting the 1978 Amendments and the decision of this Court in *Bradley* v. *School Board*, *supra*. Review by this Court is plainly warranted.

1. In *Bell* v. *New Jersey*, *supra*, this Court unanimously held that the federal government may recover misused funds "advanced as part of a federal grant-in-aid-program under Title I of the Elementary and Secondary Education Act" (slip op. 1). The Court emphasized that states are required "to honor the obligations voluntarily assumed as a condition of federal funding" (slip op. 16) and that when a state "fail[s] to fulfill those assurances, * * * [it becomes] liable for the funds misused, as the grant specified" (slip op. 17).[3]

[3] The Court did not find it necessary at that stage of the case to address directly the question presented here—whether the substantive provisions of the 1978 Amendments apply retroactively (slip op. 3 n.3). It did, however, retroactively apply the provisions of the 1978 Amendments that merely changed the forum for review from the Title I Audit Hearing Board to the Education Appeal Board, noting that "[a]s Justice Holmes explained for the Court in *Hallowell* v. *Commons*, 239 U.S. 506, 508 (1916), a change of forum 'takes away no substantive right' and thus can apply retroactively" (*Bell* v. *New Jersey*, slip op. 4 n.3). In contrast, the retroactive application of the revised standards now at issue deprives the Secretary of the substantive right to recoup misspent grant funds.

The court of appeals nevertheless concluded that respondent can avoid such liability, even though it failed to fulfill an assurance made when the funds were received and expended, if it can show that *subsequent* grants did not require the giving of that assurance. This conclusion cannot be reconciled with the approach of other courts of appeals, which have consistently analyzed the terms of the statutes and regulations in effect when the expenditures were made to determine whether the expenditures were proper. See, *e.g.*, *Indiana* v. *Bell*, 728 F.2d 938, 941 n.6 (7th Cir. 1984); *Kentucky* v. *Secretary of Education*, 717 F.2d 943, 945, 947 n.9 (6th Cir. 1983), petition for cert. pending, No. 83-1798; *West Virginia* v. *Secretary of Education*, 667 F.2d 417, 420 (4th Cir. 1981). Cf. *Woods* v. *United States*, 724 F.2d 1444, 1446 n.1 (9th Cir. 1984) (Food Stamp Program); *North Carolina Comm'n of Indian Affairs* v. *Dep't of Labor*, 725 F.2d 238, 239 (4th Cir. 1984) (CETA Program).

These decisions, unlike the one below, conform to the basic principle that a grantee, in exchange for federal funds, agrees to comply with specific terms and conditions relating to the use of those funds. See, *e.g.*, *Pennhurst State School & Hospital* v. *Halderman*, 451 U.S. 1, 17 (1981); *King* v. *Smith*, 392 U.S. 309 (1968). As Justice White stated in his concurring opinion in this

Court's prior decision in this case, *Bell* v. *New Jersey*, No. 81-2125, slip op. 2:

> The States entered into contractual-type agreements with the United States to disburse the [Title I] monies in accordance with specified conditions. The States had no legitimate claim to a right to be able to breach these conditions with impunity. In the absence of any contrary congressional intent, agreements such as these are surely enforceable.

The "specified conditions" agreed to by respondent in exchange for Title I funds during 1970-1972 were the statute and regulations then in effect, not statutory changes enacted more than six years after the grant funds were expended.

2.a. The court of appeals erred in ignoring the basic and longstanding rule of statutory construction that substantive legislation must apply prospectively, unless there is a clear legislative intent to the contrary. *United States* v. *Security Industrial Bank*, 459 U.S. 70, 79 (1982); *Greene* v. *United States*, 376 U.S. 149, 160 (1964); *Claridge Apartments Co.* v. *Commissioner*, 323 U.S. 141, 164 (1944); *United States* v. *Magnolia Petroleum Co.*, 276 U.S. 160, 162-163 (1928) ("Statutes are not to be given retroactive effect or construed to change the status of claims fixed in accordance with earlier provisions unless the legislative purpose to do so plainly appears." (citing cases)); *Cameron* v. *United States*, 231 U.S. 710, 720 (1914) ("In the absence of a clearly expressed legislative intent to the contrary the court will presume that the law-making power is acting for the future and does not intend to impair obligations incurred or rights relied upon in the past conduct of men when other legislation was in force."); *United States* v. *Heth*, 7 U.S. (3 Cranch) 339, 413 (1806); Smead, *The Rule Against Retroactive Legislation: A Basic Principle of Jurisprudence*, 20 Minn. L. Rev. 775

(1936). As this Court stated in *Union Pacific R. R.* v. *Laramie Stock Yards Co.*, 231 U.S. 190, 199 (1913):

> [T]he first rule of construction is that legislation must be considered as addressed to the future, not to the past. * * * [A] retrospective operation will not be given to a statute which interferes with antecedent rights * * * unless such be "the unequivocal and inflexible import of the terms, and the manifest intention of the legislature."

The new eligibility requirements enacted as part of the 1978 Amendments were clearly substantive legislation, relating to the standards and conditions under which school districts accepted and used Title I grant funds. Nothing in either the requirements themselves or their legislative history even suggests, much less unequivocally requires, that they are to be applied retroactively.

Indeed, Congress's intent to apply 20 U.S.C. 2732(a)(1) prospectively is apparent both from the terms of the statute and from its legislative history. The statute specifies that October 1, 1978, is its effective date (Pub. L. No. 95-561, § 1530, 92 Stat. 2380)—a strong indication that it is to be applied only to grants made after that date. That reading is reinforced by 20 U.S.C. 2702, which also indicates a prospective period of applicability for the new substantive Title I requirements:

> During the period beginning October 1, 1978, and ending September 30, 1983, the Secretary shall, in accordance with the provisions of this subchapter, make payments to State educational agencies for grants made on the basis of entitlements created under this subchapter.

The legislative history supports this language. The House Report states that the changed requirements clarify "the manner in which school districts *are to distribute* Title I funds among eligible schools and children," thus confirming that the changes apply only to

future grants. H. R. Rep. 95-1137, 95th Cong., 2d Sess. 21 (1978) (emphasis added).

The court of appeals erroneously found a contrary legislative intent in statements in the hearings that the 1978 Amendments were designed to correct a perceived "injustice * * * [to] areas with high concentrations of low income families" (App., *infra*, 4a (footnote omitted)). But the statements to which the court referred (*id.* at 4a n.2) contain no mention of the change at issue here in the eligibility requirements for school attendance areas. In any event, although the House and Senate Reports refer generally to a congressional intent to "clarify" existing Title I requirements (H.R. Rep. 95-1137, 95th Cong., 2d Sess. 22 (1978); S. Rep. 95-856, 95th Cong., 2d Sess. 130 (1978)), such references hardly show that the amendments were intended to affect grants that had previously been made. See *LTV Federal Credit Union* v. *UMIC Government Securities*, 704 F.2d 199, 202 (5th Cir. 1983); *Sikora* v. *American Can Co.*, 622 F.2d 1116, 1121 (3d Cir. 1980). The court of appeals cited no evidence demonstrating "the manifest intention of the legislature" to "interfere[ ] with antecedent rights" (*Union Pacific R.R.* v. *Laramie Stock Yards Co.*, *supra*).[4]

Any possible doubt concerning the legislative intent in this regard is laid to rest by 1 U.S.C. 109, the general savings statute, which provides that "[t]he repeal

[4] We note that, in 1981, the Senate considered an amendment to an appropriations bill that would have relieved the states of any obligation to repay Title I funds that had been misspent before 1978. Although the amendment was ultimately defeated on a point of order (127 Cong. Rec. S5429 (daily ed. May 21, 1981)), nothing in the debate concerning the desirability of forgiving the accrued liabilities of the states remotely suggests that those liabilities—which were calculated on the basis of the standards prevailing at the time of the expenditures—had been altered in any way by the 1978 "clarification" of those standards.

of any statute shall not have the effect to release or extinguish any * * * liability incurred under such statute, unless the repealing Act shall expressly so provide, and such statute shall be treated as still remaining in force for the purpose of sustaining any proper action or prosecution for the enforcement of such * ** liability." This statute applies to amendments, as well as outright repeals. *Warden* v. *Marrero*, 417 U.S. 653, 660 (1974); *United States* v. *Mechem*, 509 F.2d 1193, 1194 n.3 (10th Cir. 1975). Moreover, "the term 'liability' as used in the general savings statute has been broadly construed by the courts to comprehend all obligations arising out of any breach of a statutory duty." *NLRB* v. *National Garment Co.*, 166 F.2d 233, 237 & n.4 (8th Cir. 1948) (citing cases); accord, *Hertz* v. *Woodman*, 218 U.S. 205, 217-218 (1910). See also *United States* v. *Carter*, 171 F.2d 530 (5th Cir. 1948) (applying statute to require restitution of overcharges to purchasers of housing under expired statute). There is certainly nothing in the 1978 Amendments that expressly prohibits the continuing applicability of the substantive standards under which the 1970-1972 grants were made; the general savings statute thus provides that the obligations the states voluntarily undertook concerning the ways in which those grants would be expended remain enforceable.

b. *Bradley* v. *School Board*, 416 U.S. 696 (1974), upon which the court of appeals relied (App, *infra*, 4a), does not support the retroactive application of the substantive eligibility standards in the 1978 Amendments to grants made and expended when earlier statutory provisions were in effect. In *Bradley*, this Court stated (416 U.S. at 711) that an appellate court should generally apply the law in effect at the time it renders its decision unless to do so would work a manifest injustice or would be inconsistent with the legislative intent. As we have shown, there is such inconsistency here. Further-

more, application of the substantive eligibility requirements of the 1978 Amendments to these claims would be manifestly unjust.

Indeed, the *Bradley* principle has only been followed in civil cases where application of the law in effect at the time of a court's decision would not alter material substantive rights or affect liability for prelitigation conduct. Thus, it has been followed in retroactively applying new statutes concerning remedies or procedures for matters such as attorney's fees (*Bradley* v. *School Board*, *supra*; *Hutto* v. *Finney*, 437 U.S. 678 (1978)), injunctive relief for future violations (*Cort* v. *Ash*, 422 U.S. 66 (1975)), and jury instructions where the changed law "did not extinguish a cause of action" (*Gulf Offshore Co.* v. *Mobil Oil Corp.*, 453 U.S. 473 (1981)). But the Court has consistently refused to apply the *Bradley* principle in circumstances that affect a party's substantive rights. See, *e.g.*, *United States* v. *Security Industrial Bank*, *supra*; *Employees* v. *Missouri Pub. Health Dep't*, 411 U.S. 279 (1973); see also *Bradley*, 416 U.S. at 720 ("The Court has refused to apply an intervening change to a pending action where it has concluded that to do so would infringe upon or deprive a person of a right that had matured or become unconditional."); *Hutto* v. *Finney*, 437 U.S. at 695.

The court of appeals believed that the "presumption of retroactivity is particularly strong" because the 1978 Amendments were allegedly "remedial" (App., *infra*, 4a). It is frequently stated that remedial statutes are to be applied to cases pending at the time of enactment. See, *e.g.*, *Koger* v. *Ball*, 497 F.2d 702, 705-706 (4th Cir. 1974); *Silverlight* v. *Huggins*, 488 F.2d 107, 109 (3d Cir. 1973); *Connett* v. *Jerseyville*, 96 F.2d 392, 400 (7th Cir. 1938); cf. *Funkhouser* v. *Preston Co.*, 290 U.S. 163, 167-168 (1933). For purposes of retroactivity analysis, however, a remedial statute is one that neither enlarges nor impairs substantive rights, but rather

relates to the means and procedures for enforcing those rights. *McGee* v. *International Life Ins. Co.*, 355 U.S. 220 (1957); *Winfree* v. *Northern Pac. Ry.*, 227 U.S. 296, 301-302 (1913).[5]

The court of appeals also found it significant that "the case * * * involves a public matter of great national concern and is argued on direct appeal by two public agencies. This is not the routine private lawsuit in which a retrospective application of a law would disadvantage a private party who had relied on a settled body of private law. *See Bradley*, *supra*, 416 U.S. at 716-721" (App., *infra*, 5a). In this regard as well, the court below misinterpreted *Bradley*. That case does not suggest that retroactivity analysis should overlook unfairness to public entities, even when a case involves a matter of great national concern. Instead, the Court in *Bradley* emphasized the disparity in the resources available to the litigants there: the "publicly funded" School Board and the "class of children whose constitutional right to a nondiscriminatory education" was directly served by the litigation (416 U.S. at 718). In that context, the Court noted that the great national concern of furthering such education would be enhanced by a full award of attorney's fees. But the Court also emphasized (416 U.S. at 720) that such an award was not unfair to the School Board, which from the outset of the litigation had had a constitutional obligation to provide a nondiscriminatory education and also knew that it

---

[5] *Tcherpnin* v. *Knight*, 389 U.S. 332 (1967), the only case cited by the court of appeals, has nothing to do with retroactivity. There, the Court held that the Securities Exchange Act of 1934 was "remedial" in the sense that it provided a new substantive remedy for previously inadequately protected interests, and that it therefore should be interpreted broadly to effectuate that remedial purpose. The Court certainly did not suggest that, because the Act was remedial, it should apply to conduct occurring before the Act was passed.

faced the possibility that it would be required to pay attorney's fees (416 U.S. at 721).

In contrast, here there is no such striking disparity in the resources available to the litigating parties, and no national concern that would be even indirectly served by denying recoupment of misspent grant funds. See *Bell* v. *New Jersey*, slip op. 9 n.8.[6] Instead, the issues presented by this case, "even though raised by a state, are closely akin to private wrongs" (*Oklahoma* v. *Civil Service Comm'n*, 330 U.S. 127, 136-137 (1947)). Furthermore, there was certainly no abrogation of responsibilities by the Secretary with knowledge of the possible consequences. The final determination letter, demanding the repayment of misspent Title I funds, was sent on June 11, 1976, well before enactment of the 1978 Amendments (App., *infra*, 32a).

In fact, the *Bradley* analysis suggests that retroactive application of the substantive provisions of the 1978 Amendments would be inappropriate in this context, because denying retroactivity will further the policies of the ESEA by permitting effective audits and thus by encouraging grantees to conform to their voluntarily accepted obligations. On the other hand, the retroactive application adopted by the court below will seriously complicate agency efforts to audit state compliance with grant conditions and to correct deficiencies identified in that process, particularly in programs where close congressional oversight results in frequent statutory changes in the conditions under which grants are made.

An audit necessarily assumes that the standards to be applied are fixed—otherwise, there is simply no way to determine whether certain expenditures were proper. If those standards change during the course of administrative or judicial review after the audit is completed, the information needed to determine whether the expenditures complied with the new standards may simply not be available, even if a new audit is conducted. For example, here the court of appeals directed the Secretary to determine whether respondent satisfied the requirements of the 1978 Act for each school attendance area that received Title I funds in the relevant years, but there is no assurance that the records necessary to make that determination for 1970-1972 are still available, or indeed were even collected.[7] And, of course, where, as in the ESEA, the statute is regularly amended, the process can go on indefinitely. Although the court of appeals directed the Secretary to apply the 1978 standards, by the time the decision issued the 1981 Act had once again altered the relevant standards. See Pub. L. No. 97-35, 95 Stat. 464, 20 U.S.C. 3801 *et seq*. The need for finality thus argues strongly against the result below.

---

[6] Significantly, the reference in *Bradley* to "great national concerns" (416 U.S. at 719) derived from Chief Justice Marshall's language in *United States* v. *The Schooner Peggy*, 5 U.S. (1 Cranch) 103, 110 (1801), in which the Court applied the peace treaty with France to require the return of a ship seized during the war. There, the Court explained that "in great national concerns where individual rights, acquired by war, are sacrificed for national purposes, the contract, making the sacrifice, ought always to receive a construction conforming to its manifest import * * *." There is, of course, no remotely similar national concern at issue here. Instead, as in *Sikora* v. *American Can Co.*, 622 F.2d 1116, 1122 (3d Cir. 1980), "resolution of this case [will] not cause repercussions in the international community, nor [will] it implicate long standing constitutional violations as in *Bradley*."

[7] Under regulations in effect at the time involved in this case, Title I expenditure records were not required to be maintained beyond five years unless they were involved in an audit; there was no requirement that a state keep expenditure records of the kind necessary for a determination of compliance with the new standard (20 U.S.C. 2732(a)(1)). 45 C.F.R. 116.54 (1972). Accord, 34 C.F.R. 200.56 (Chapter 1 recordkeeping requirement).

3. The financial impact of the court of appeals' decision is difficult to quantify, but it will surely be substantial. Because both the Education Amendments of 1978 and the successor program, Chapter 1 of the Education Consolidation and Improvement Act of 1981, 20 U.S.C. 3801 *et seq.*), generally were designed to simplify grant procedures and to relax many of the standards with which the states must comply as a condition of eligibility for federal funds, the principle of retroactivity espoused by the court below has a potentially broad applicability to audits under the earlier statutes, as well as to audits under the 1978 Amendments. Thus, defenses based on the decision below can be expected in a substantial number of pending cases, in which approximately $68 million in Title I audit claims are in dispute.

Nor is the impact of this erroneous decision limited to the Title I program. As we noted in our petition (at 17-18), in *Bell* v. *Kentucky*, petition for cert. pending, No. 83-1798, the Office of Management and Budget has informed us that a survey of a sample of the major federal granting agencies, responsible for approximately 38% of the total Fiscal Year 1983 grants, shows that there are currently some $830 million in audit exceptions outstanding. It is not unusual for statutory or regulatory standards to be changed between the time that grant funds are spent and the demand for repayment is made at the conclusion of the audit process. If those changes impose conditions on grant recipients that are more stringent—or simply different—than those to which they agreed to conform when they received and expended the funds, it is clear that the failure to comply with the subsequent conditions, no matter how desirable or "remedial" they may be as a matter of policy, is no ground for demanding the repayment of funds that were properly expended under the conditions applicable at the time the expenditures were made. Cf. *Pennhurst State School & Hospital* v. *Halderman*, 451 U.S. at 24. The result should be the same when the subsequent conditions are less, rather than more, stringent: the propriety of the expenditures still should be judged by the standards in effect when they were made, not by those subsequently enacted for later grants.

In sum, the decision of the court of appeals clouds the standards to be applied in auditing compliance with billions of dollars in federal grants-in-aid. This uncertainty will seriously complicate the audit process itself, and the resolution of any disputes that arise out of that process. Like the related decision in *Bell* v. *Kentucky*, No. 83-1798, the decision below thus creates a problem that, in the absence of a definitive correction by this Court, can be expected to recur with some frequency and to exacerbate federal-state relations whenever it does so.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

REX E. LEE
Solicitor General
RICHARD K. WILLARD
Acting Assistant Attorney General
KENNETH S. GELLER
Deputy Solicitor General
HARRIET S. SHAPIRO
Assistant to the Solicitor General
AL J. DANIEL, JR.
Attorney

JUNE 1984

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 80-1991

STATE OF NEW JERSEY, DEPT. OF EDUCATION,
PETITIONER

v.

SHIRLEY HUFSTEDLER, SECRETARY
OF EDUCATION, ETC.,
RESPONDENT

Petition for Review of Decisions of the
United States Department of Education
On Remand From the Supreme Court
of the United States

Argued October 26, 1983

Before: ADAMS, HUNTER, and HIGGINBOTHAM,
Circuit Judges

(Filed December 27, 1983)

OPINION OF THE COURT

ADAMS, *Circuit Judge*

The State of New Jersey asks us to review a final decision of the Secretary of Education that New Jersey refund over $1 million granted by the federal government under Title I of the Elementary and Secondary Education Act of 1965 (ESEA), 20 U.S.C. § 241a *et seq.* (1976). These funds have been allocated to local educational agencies under State supervision to meet the

special needs of "educationally deprived" children in areas with high concentrations of children from low-income families. *Id.* at § 241a. The dispute between the State and the Secretary has been explained in considerable detail in *New Jersey* v. *Hufstedler*, 662 F.2d 208 (3d Cir. 1981), where this Court held that the Secretary did not have the authority to recover Title I funds allocated before the Education Amendments of 1978, which specifically authorize the recovery of misspent funds.

In *Bell* v. *New Jersey and Pennsylvania*, 103 S.Ct. 2187 (1983), the Supreme Court reversed the decision in *New Jersey* v. *Hufstedler*, *supra*, and remanded the case to this Court so that we might "review the challenges raised by [the] State" and determine whether the Secretary's decision "is supported by substantial evidence and by the application of proper legal standards. . . ." *Id.* at 2198. Having decided only that states can be held liable for the misuse of funds under the Education Act, the Supreme Court left it to us to determine, at least in the first instance, whether the substantive standards of the 1978 amendments apply to grants approved under earlier standards. *Id.* at 2192 n.6. We hold that the later standards do apply and remand the case to the Secretary for specified factual determinations.

I

When an auditor's report first questioned Newark's allocation of Title I grants to various "school attendance areas," the statutory standard for disbursing such funds provided that Title I payments be used for projects "designed to meet the special educational needs of educationally deprived children in school attendance areas having high concentrations of children from low-income families." 20 U.S.C. § 241e(a)(1) (1976). This broad standard was interpreted as covering (1) attendance areas in which the number of children from low-income families was as large as, or larger than, the av-

erage number of such children in the various attendance areas of the school district and (2) attendance areas in which the percentage of such children was as large as, or larger than, the percentage in the school district. 45 C.F.R. § 116.17(d) (1972). In determining the Title I eligibility of its attendance areas in 1970-72, Newark used a method of calculating ratios and percentages that arguably overstated the relative size of the class of students from low-income families.

Throughout this litigation, New Jersey has maintained that the regulations implementing ESEA defeat the legislative goal of meeting the special needs of the educationally deprived. Attendance areas with concentrations of children from low-income families as high as thirty percent have been declared ineligible for Title I aid, simply because they are situated in school districts with even higher levels of poverty. To remedy such inequities, Congress passed a series of amendments to ESEA in 1978 that, under certain circumstances, permit local educational agencies to declare a school attendance area eligible for Title I funds if at least twenty five percent of the children in that area come from low-income families. 20 U.S.C. § 2732(a)(1) (Supp. V. 1981). New Jersey requests that we measure the eligibility of Newark's school attendance areas to receive Title I funding according to this newer standard.[1]

---

[1] New Jersey raises this argument for the first time in its brief upon remand. Generally, federal appellate courts do not consider issues that have not been passed on by the agency or district court whose action is being reviewed. *Singleton* v. *Wulff*, 428 U.S. 106, 120 (1976). This is a rule of discretion, rather than jurisdiction, however, and our practice has been to hear issues not raised in earlier proceedings when special circumstances warrant an exception to the general rule. *See e.g.*, *Selected Risk Ins. Co.* v. *Bruno*, 718 F.2d 67 (3d Cir. 1983); *Abrams* v. *U.S. Dept. of Navy*, 714 F.2d 1219 (3d Cir. 1983). Since New Jersey raises an issue of national importance, which is singularly within the competence of appellate courts and is

II

A federal court or administrative agency must "apply the law in effect at the time it renders its decision, unless doing so would result in manifest injustice or there is statutory direction or legislative history to the contrary." *Bradley* v. *School Board of the City of Richmond*, 416 U.S. 696, 711 (1964). There is little to suggest that such an application would result in manifest injustice here, and nothing in the 1978 amendments or the legislative history indicates that the amendments were not intended to be applied retroactively. The legislative record is replete with evidence that Congress enacted these amendments to correct the injustice that the earlier eligibility standards worked on areas with high concentrations of low income families.[2] In the proceeding before us, for example, three Newark attendance areas with a "low income percentage" of over 25 percent and seven with a percentage over 30 percent were declared ineligible for Title I aid because the district-wide percentage of children from low-income families was 33.9 percent.

Two considerations inform our judgment that the retroactive application of the new eligibility standards is appropriate. First, the 1978 amendments to the ESEA were designed to correct regulations that frustrated the basic objectives of the Title I program. Since this legislation is remedial, the presumption of retroactivity is particularly strong. *See Tcherepnin* v. *Knight*, 389

---

not predicated on complex factual determinations, we will consider the State's argument as to the retroactivity of the 1978 ESEA amendments.

[2] Elementary and Secondary Education: Hearings on H.R. 15 Before the Subcomm. on Elementary, Secondary, and Vocational Education of the House Comm. on Education and Labor, Part 16, Services and Student Development; Part 18: Administration of Title I of ESEA; Part 19: Title I—Funds Allocation, 95th Cong., 1st Sess. 194-197, 134-141, 857-861 (1977).

U.S. 332, 336 (1967). Second, the case before us involves a public matter of great national concern and is argued on direct appeal by two public agencies. This is not the routine private lawsuit in which a retrospective application of a law would disadvantage a private party who had relied on a settled body of private law. *See Bradley*, *supra*, 416 U.S. at 716-721. Our decision to apply the 1978 amendments retroactively might make it more difficult, as the Secretary argues, to recover "misspent" funds, but we believe that Congress determined in 1978 that the Department's method for allocating Title I funds thwarted the basic goals of that program.

III

Our decision today, unfortunately, will not bring this protracted controversy to an end. While the record does indicate that several of the school attendance areas in question had low-income percentages in excess of 25 percent, these areas could qualify for Title I funds in any given year under the newer legislation, only if the total amount of funds expended under Title I and similar State programs equaled or exceeded the total amount expended from the combined sources in the preceding year. 20 U.S.C. § 2732(a)(1) (Supp. V 1981). Since the record before us does not allow for such a calculation, the Secretary of Education will be required to make this determination for each school attendance area that had a Title I project in the relevant years.

Accordingly, this matter will be remanded to the Secretary for proceedings consistent with this opinion.

A True Copy:

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 80-1991
No. 80-2302

STATE OF NEW JERSEY,
DEPARTMENT OF EDUCATION,
PETITIONER IN No. 80-1991

v.

SHIRLEY HUFSTEDLER,
SECRETARY OF EDUCATION,
UNITED STATES DEPARTMENT OF EDUCATION,
RESPONDENT IN No. 80-1991

COMMONWEALTH OF PENNSYLVANIA,
PETITIONER IN No. 80-2302

v.

SECRETARY OF EDUCATION,
UNITED STATES DEPARTMENT OF EDUCATION,
RESPONDENT IN No. 80-2302

PETITIONS FOR REVIEW OF DECISIONS OF THE
UNITED STATES DEPARTMENT OF EDUCATION

Argued May 18, 1981

Before ADAMS, ROSENN, and HIGGINBOTHAM,
Circuit Judges

(Opinion Filed October 13, 1981)

OPINION OF THE COURT

ROSENN, *Circuit Judge.*

These petitions for review of final decisions of the United States Department of Education ("Department" or "Agency")[1] present important questions of first impression in this court. The decisions under review are orders directing petitioners New Jersey and Pennsylvania ("States") to refund to the Department federal funds distributed to the States under the provisions of Title I of the Elementary and Secondary Education Act of 1965 as amended[2]

---

[1] The Department of Education was created by the Department of Education Organization Act, Pub. L. No. 96-88, 93 Stat. 668 (1979) (codified at 20 U.S.C. §§ 3401-3508 (Supp. III 1979)) and is the successor agency to the former Office of Education ("OE") in the Department of Health, Education and Welfare ("HEW"). The transfer of functions authorized by the act occurred on May 4, 1980, at the direction of the President. Exec. Order No. 12,212, 3 C.F.R. 255 (1981), *reprinted in* [1980] U.S. Code Cong. & Ad. News 7826. Only the very last stages of the adminsitrative proceedings in the cases before us took place after the transfer of functions. However, for purposes of clarity, the former designations of "Office of Education" and "Commissioner of Education" will be used in this opinion only when precision is necessary, otherwise being subsumed in the references to the "Department of Education" and the "Secretary of Education."

[2] Pub. L. No. 89-10, 79 Stat. 27, *amended by* Pub. L. No. 89-750, 80 Stat. 1191 (1966); Pub. L. No. 90-247, 81 Stat. 783 (1967); Pub. L. No. 91-230, 84 Stat. 121 (1969, *enacted* 1970); Pub. L. No. 92-318, 86 Stat. 235 (1972); Pub. L. No. 93-380, 88 Stat. 484 (1974); Pub. L. No. 94-482, 90 Stat. 2081 (1976); Pub. L. No. 95-112, 91 Stat. 911 (1977); Pub. L. No. 95-561, 92 Stat. 2143 (1978); *and* Pub. L. No. 96-46, 93 Stat. 338 (1979). The various pieces of amending legislation will be referred to by the date contained in their short titles—*e.g.*, 1969 Amendments. Footnote references to public law number and session law citation will be provided as appropriate.

("ESEA") and determined by the Agency audits to have been misapplied under the terms of that Act and its implementing rules and regulations.[3] The States have refused to comply with the Department's directives because they contend that the Agency is without authority under the Act to recover through administrative proceedings Title I funds that were misspent during the years in question.[4] Additionally, New Jersey challenges the correctness of the Agency's audit findings; Pennsylvania challenges the Department's interpretation and application of the Act's statute of limitations and claims that its rulemaking procedures are deficient. We reach only the question of the Agency's claimed authority to issue the orders presently before us and conclude that such authority does not exist. We therefore reverse.

I.

In 1965, as his education program was nearing floor debate in the Senate, President Johnson, com-

[3] 45 C.F.R. pts. 116 & 116a (1980) (to be transferred to 34 C.F.R. pts. 200 & 201 (1981)). In addition to these codified regulations the Agency implements the Act in several less formal manners. For example, the Agency has established mandatory criteria in its program guidelines, which are distributed to nonfederal agencies preparing applications for participation in Title I. The Agency also distributes program manuals to participating entities and will often issue letter memoranda in response to inquiries of local or state educational agencies. *See generally* The National Institute of Education, DHEW, *Administration of Compensatory Education* 5-7 (Report to Congress 1977).

[4] New Jersey's Title I program was audited for the period September 1, 1970 through August 31, 1973. The Department's assessment against Pennsylvania stems from an audit report of that state's program from July 1, 1967 through June 30, 1973.

BEST AVAILABLE COPY

menting on the bill that was to become the Elementary and Secondary Education Act of 1965, said: "This bill has a simple purpose: To improve the education of young Americans." [5] Beginning with the ESEA, legislation passed in pursuit of that laudable objective fundamentally altered the federal government's remote role in education. The Senate committee report on ESEA notes this change in direction by quoting Senator Taft's statement expressing Congressional concerns prompting the legislation:

> "Education is primarily a State function, but in the field of education, as in the fields of health, relief, and medical care, the Federal Government has a secondary obligation to see that there is a basic floor under those essential services for all adults and children in the United States."

S. Rep. No. 146, 89th Cong., 1st Sess., *reprinted in* [1965] U.S. Code Cong. & Ad. News 1450. According to educational statistics then before the Congress, the nation had almost fallen below the "basic floor" referred to by Senator Taft and this encouraged federal intervention.[6]

[5] S. Rep. No. 146, 89th Cong., 1st Sess., *reprinted in* [1965] U.S. Code Cong., & Ad. News 1448.

[6] According to the Senate report,

> The purpose of this legislation is to meet a national problem. This national problem is reflected in draft rejection rates because of basic educational deficiencies. It is evidenced by the employment and manpower retraining problems aggravated by the fact that there are over 8 million adults who have completed less than 5 years of school. It is seen in the 20-percent unemployment rates of our 18- to 24-year-olds. It is voiced by our institutions of higher learning and our vocational and technical edu-

Without doubt, the provisions of ESEA Title I effectuated one of the most ambitious federal forays into the educational domain. Confronted with overwhelming evidence of a direct link between economic privation and educational underachievement, Congress authorized a massive [7] infusion of federal funds into the nation's public school systems for the improvement of the educational lot of children from low-income families. In Title I, however, Congress has done more than simply "throw money at a problem." The statutory scheme has been carefully constructed to ensure that the funds appropriated for the benefit of disadvantaged schoolchildren are actually applied and distributed in the most equitable and efficient manner.

For example, the amount of a grant to a particular local educational agency ("LEA") is determined by direct reference to the number of children from low-income families eligible to attend the schools served by the LEA. Pub. L. No. 874, tit. II, § 203, *as added by* Pub. L. No. 89-10, tit. I, § 2, 79 Stat. 27, 28 (1965) (*codified as amended at* 20 U.S.C. § 2711 (Supp.III 1979)). Federal funds are to be distributed only after the state educational agency

---

cators who have the task of building on elementary and secondary education foundations which are of varying quality and adequacy.

S. Rep. No. 146, 89th Cong., 1st Sess., *reprinted in* [1965] U.S. Code Cong. & Ad. News 1449.

[7] In Title I's first year, Congress appropriated $775,000,000 to the program. Departments of Labor, and Health, Education, and Welfare Supplemental Appropriation Act, 1966, Pub. L. No. 89-199, ch. II, 79 Stat. 831, 832 (1965). By 1979, funding levels had reached $3,077,132,000. Departments of Labor and Health, Education, and Welfare Appropriations Act, 1979, Pub. L. No. 95-480, tit. II, 92 Stat. 1567, 1577 (1978).

("SEA") to which the particular LEA is responsible has provided assurances that the LEA, under the SEA's direction, will expend the federal monies only on "programs and projects . . . (A) which are designed to meet the special education needs of educationally deprived children in school attendance areas having high concentrations of children from low-income families and (B) which are of sufficient size, scope, and quality to give reasonable promise of substantial progress toward meeting those needs . . . ." Pub. L. No. 874, tit. II, § 205, *as added by* Pub. L. No. 89-10, tit. 1, § 2, 79 Stat. 27, 30 (1965) (*codified as amended at* 20 U.S.C. § 2734 (Supp.III 1979)).

The federal program prohibits the use of funds to supplant an existing state-funded compensatory education program, requires LEA's to maintain their existing commitment in the area as a condition to continued eligibility, and prescribes that only the excess costs incurred as a result of instituting Title I programs shall be paid with Title I funds. 20 U.S.C. § 2736 (Supp.II 1979). The Act also establishes very definite criteria to be used in identifying the schools and attendance areas in which Title I funds may be expended, 20 U.S.C. § 2732 (Supp.III 1979), as well as the children that may be served. 20 U.S.C. § 2733 (Supp. III 1979). As might be expected, the specificity and complexity of the statutory restrictions on the use of Title I funds are modest when compared with the intricate set of rules and regulations adopted by the administering federal agency. *See* 45 C.F.R. pts. 116 & 116a (1980) *and* note 3 *supra*.

Although this overview of the program might suggest a rigid and pervasive federal presence at all levels of Title I administration, in keeping with traditional governmental roles in education, Congress actually entrusted most of the responsibility for man-

agement to the SEA's and the primary responsibility for innovative program development to the LEA's. Basically, the Act contemplates that each LEA that desires to receive Title I funds will file an application detailing its needs, its eligibility, and the intended uses for the requested funds. This application is submitted to the SEA, which verifies its accuracy and ensures that all proposals conform with current Title I guidelines. The SEA after collecting all LEA applications from its jurisdiction, then submits its own application to the Department for the aggregate sum to which its LEA's are eligible (according to their applications), plus an amount for administration expenses. This application is accompanied by assurances from the SEA that the funds will be used only for lawful Title I purposes.

The resolution of the questions presented by this case therefore is of considerable importance in administering the Title I program. Congress chose to rely heavily on the States to assure proper application of Title I funds, but committed to the Department the authority to adopt such rules and regulations as it deemed appropriate. Such a division of responsibility must inevitably lead to conflicts between the SEA's and the Department over the proper application of Title I funds. When conflicts have developed, the Department has resorted to a variety of procedures, all directly related to its power over the purse strings, to enforce its interpretation of the Act against the States. Some, such as withholding funds or refusing to approve applications, find their roots in the clear and unambiguous terms of the statute in effect when the deposited funds were received. Pub. L. No. 874, tit. II, §§ 206, 210, *as added by* Pub. L. No. 89-10, tit. I, § 2, 79 Stat. 31, 33 (1965) (*codified as amended at* 20 U.S.C. §§ 2832,

2836 (Supp. III 1979)). In this case, however, the Department adopted procedures for the Pennsylvania and New Jersey audit proceedings not clearly authorized by the statute under which the funds were disbursed. It is this variance in procedure that is the genesis of this litigation.

A.

To understand fully the issue we decide today, a brief examination of the administrative proceedings that have brought these cases to us is necessary. The Department, in carrying out its statutory responsibilities, performed separate audits of the Pennsylvania and New Jersey Title I programs. The initial audits were performed by auditors employed by the Department of Health, Education and Welfare Audit Agency ("HEWAA"). In its final audit reports, issued in April (Pennsylvania) and June (New Jersey) of 1975, HEWAA found that both States had misapplied substantial sums of federal Title I monies during the periods under investigation. These reports were forwarded to the Deputy Commissioner for Elementary and Secondary Education, who solicited responses from the States. On May 18, 1976, the Deputy Commissioner issued a final audit determination letter on the Pennsylvania audit. In his letter addressed to the SEA, the Deputy Commissioner sustained the audit findings that $1,346,399.00 had been misspent in Pennsylvania during the audit period and ordered the State to refund that sum to the Department. He sent a similar final audit determination letter to the New Jersey SEA on June 11, 1976, and demanded a refund of $1,161,917.00.

Upon receipt of the Deputy Commissioner's final audit determination letters, both States filed applications for review with the Title I Audit Hearing

Board.[8] Panels of that Board held hearings[9] on the State's objections and, in written decisions dated February 19, 1980, (New Jersey) and May 7, 1980, (Pennsylvania), modified the Deputy Commissioner's findings and assessed audit deficiencies of $1,031,304[10]

[8] The Department's briefs to this court explain that "[a]lthough under no legal requirement to do so, OE created the Board to give [SEA's] a fair opportunity to rebut adverse final audit determinations of the Deputy Commissioner before an independent administrative tribunal."

[9] On June 29, 1979, the Education Appeal Board ("EAB" or "Board"), created by Pub. L. No. 95-561, tit. XII, § 1232, 92 Stat. 2347 (1978) (*codified at* 20 U.S.C. § 1234 (Supp. III 1979)) assumed jurisdiction of all cases then pending before the Title I Audit Hearing Board. 44 Fed. Reg. 43807 (July 26, 1979). However, the transfer of functions caused few practical disruptions because the composition of the EAB was identical to that of the Title I Audit Hearing Board. Pennsylvania, however, claims to have suffered from the transfer because the notice of the establishment of the EAB, given May 25, 1979, 44 Fed. Reg. 30528, which included rules governing procedures before the EAB indicated that the procedures were in effect immediately. Thus, Pennsylvania claims, and the Department does not deny, that the State was forced to try the portion of its case heard after May 25, 1979, under new and unfamiliar rules. Pennsylvania also asserts that the Department's final regulations governing the EAB, substantially identical to the interim final regulations under which post-May 25 hearings were held, were disapproved by Congress pursuant to 20 U.S.C. § 1232(d) (1976 & Supp. III 1979).

[10] This reduction resulted from the application of a five-year statute of limitations enacted in 1974, Pub. L. No. 93-380, tit. I, § 106, 88 Stat. 484, 512, *originally codified at* 20 U.S.C. § 884 (1976), *renumbered and replaced*, Pub. L. No. 95-561, §§ 801(2), 901(b), 93 Stat. 2284, 2305 (1978), *as amended by* Pub. L. No. 96-46, §§ [1](20), 2(a)(3), 93 Stat. 339-40 (1979). *Cf.* Pub. L. No. 90-247, tit. IV, § 452(g), *as added by* Pub. L. No. 95-561, § 1232, 92 Stat. 2347-49 (1978) (prescribing a five-year statute of limitations for refund proceedings effected under the General Education Provisions Act).

against New Jersey and of $422,424.29[11] against Pennsylvania. The Board's decisions were subject to a comment period during which they were forwarded to the Secretary, who declined to review them. The Board's decision as to New Jersey became the final decision of the Department on May 2, 1980; the decision as to Pennsylvania became final on July 16, 1980. Timely petitions for review were filed in this court.[12]

As explained earlier, both Pennsylvania and New Jersey contend that, to the extent the above-described procedures directed the payment of a refund by the SEA's, the procedures were outside the Department's statutory authority. The Department responds by citing two statutory provisions that it urges explicitly authorize the procedures followed in these cases. Alternatively, the Department relies on a common-law right of the Government to recoup grant funds expended in violation of the terms and conditions of the grant. We turn first to the statute.

B.

The Government's dilemma lies not in the unreasonableness of its demands for the return of the

[11] This reduction resulted from an application of the statute of limitations, *see* note 10 *supra* and from a determination that funds had not been misspent in one of the five LEAs that were the subject of HEWAA audit deficiencies.

[12] Jurisdiction of this court is proper under either 20 U.S.C. § 2851 (Supp. III 1979) (authorizing appeals from adverse final action of the Secretary regarding Title I audits) or 20 U.S.C. § 1234d (Supp. III 1979) (authorizing appeals from adverse final action of the EAB).

misspent monies but in the absence of a statutory remedy to compel repayment. The Department first invokes a recent addition to the statutory scheme as authority for its actions in these cases. Title I's section 185 (20 U.S.C. § 2835 (Supp. III 1979)) was added by the 1978 Amendments,[13] which effectively rewrote the entire Act. Section 185 directs that when Title I audits disclose a misapplication of grant funds, the Secretary shall take steps to "assure timely

---

[13] Pub. L. No. 95-561, tit. I, § 101, 92 Stat. 2143, 2190 (1978), *adding* Pub. L. No. 89-10, tit. I, § 185. The section reads:

> § 2835. Audits and audit resolution
>
> (a) Auditing.—The Inspector General of the Department of Health, Education and Welfare shall make provision for audits of grants made under this subchapter to determine, at a minimum, the fiscal integrity of grant or subgrant financial transactions and reports, and the compliance with applicable statutes, regulations, and the terms and conditions of the grant or subgrant.
>
> (b) Audit resolution and repayment.—The Commissioner shall adopt procedures to assure timely and appropriate resolution of audit findings and recommendations arising out of audits provided for in subsection (a) of this section. Such procedures shall include timetables for each step of the audit resolution process and an audit appeals process. Where, under such procedures, the audit resolution process requires the repayment of Federal funds which were misspent or misapplied, the Commissioner shall require the repayment of the amount of funds under this subchapter which have been finally determined through the audit resolution process to have been misspent or misapplied. Such repayment may be made from funds derived from non-Federal sources or from Federal funds no accountability for which is required to the Federal Government. Such repayments may be made in either a single payment or in installment payments over a period not to exceed three years.

BEST AVAILABLE COPY

and appropriate resolution of audit findings and recommendations." This audit resolution process is expressly directed to include repayment of funds "finally determined . . . to have been misspent or misapplied." Pointing out that Section 185, and complementary sections contained in the General Education Provisions Act ("GEPA"),[14] were in effect when final agency action was taken in the cases at bar, the Department claims that the decisions under review simply fulfill the statutory obligations of the Agency to ensure the fiscal integrity of Title I at the state and local level.

The States counter the Department's Section 185 argument by invoking the general rule against retroactive application of statutory enactments:

> "[T]he first rule of construction is that legislation must be considered as addressed to the future, not the past . . . [and] a retrospective operation will not be given to a statute which interferes with antecedent rights . . . unless such be 'the unequivocal and inflexible import of the terms, and the manifest intention of the legislature.'"

Greene v. *United States*, 376 U.S. 149, 160 (1964) (quoting *Union Pacific Railroad* v. *Laramie Stock Yards Co.*, 231 U.S. 190, 199 (1913)). *See United States* v. *Richardson*, 512 F.2d 105, 106 (3d Cir. 1975).

The States further assert that retroactive enforcement of a newly created governmental right of recovery is especially inappropriate in the context of participatory grant programs involving sovereign States. It is, the States contend, in the nature of

---

[14] *See* 20 U.S.C. § 1234, 1234a (Supp. III 1979).

a grant program that a prospective grantee may exercise its prerogative not to participate. However, it is argued, for that prerogative to be exercised knowledgeably and, presumably in the case of governmental entities, in the public interest, it is necessary that the prospective grantee be able to assess the potential risks and benefits that would flow from participation. For this court, it is urged, to enforce retroactively a sanction not mentioned when the grantees entered into the program, would impose serious hardship on States operating under budgetary limitations and would result in a dramatic and undesirable reduction in the participation rates for worthy federal grant programs such as Title I.

The States' arguments are persuasive and in harmony with the views recently expressed by the Supreme Court in *Pennhurst State School and Hospital* v. *Halderman*, 49 U.S.L.W. 4363 (U.S. April 20, 1981). In *Pennhurst*, the Court reversed this court's holding that the Developmentally Disabled Assistance and Bill of Rights Act, 42 U.S.C. §§ 6000-81 (1976 & Supp. III 1979) ("DDA"), imposed affirmative obligations on the states to provide mentally retarded persons with appropriate treatment in the environment that would be least restrictive of their personal liberty. *Halderman* v. *Pennhurst State School & Hospital*, 612 F.2d 84, 94, 107 (3d Cir. 1979) (*en banc*). Referring to Congressional authority to legislate pursuant to the Spending Power,[15] the Court stated: "[O]ur cases have long recognized that Congress may

[15] The Spending Power is derived from Congress' authority to provide for the general welfare. U.S. Const. art. I, § 8, cl. 1. Department counsel agreed at oral argument that Title I was enacted in exercise of this power.

fix the terms on which it shall disburse federal money to the States." 49 U.S.L.W. at 4367. The *Pennhurst* Court then proceeded to describe Spending Power legislation as

> much in the nature of a contract: in return for federal funds, the States agree to comply with federally imposed conditions. The legitimacy of Congress' power to legislate under the Spending Power thus rests on whether the State voluntarily and knowingly accepts the terms of the "contract." . . . There can, of course, be no knowing acceptance if a state is unaware of the condition . . . . [I]f Congress intends to impose a condition on the grant of federal moneys, it must do so unambiguously . . . . By insisting that Congress speak with a clear voice, we enable the States to exercise their choice knowingly, cognizant of the consequences of their participation.

Id.

We recognize that *Pennhurst* is not directly applicable to the cases before us. That case concerned the imposition of affirmative obligations, the costs of which were not fully covered by grant funds. Nevertheless, the overarching principle of *Pennhurst*—that the terms and conditions of a federal grant must be set forth clearly and unambiguously in the statute authorizing the grant—precludes us from giving retroactive effect to a statute passed five years after the last disputed funds were received. Such a result would require repayment of misspent funds out of a state's general treasury. Section 185 does not confer authority on the Department to impose the sanctions it adopted in these cases.

The Department also relies on Section 415 of the General Education Provisions Act ("GEPA"),[16] currently codified at 20 U.S.C. § 1226a-1 (Supp. III 1979), for authority to recoup misspent Title I funds. That section provides:

> Payments pursuant to grants or contracts under any applicable program may be made in reimbursement with necessary adjustments on account of overpayments or underpayments as the Commissioner may determine.

We are at somewhat of a loss to understand the Department's arguments concerning the operative effect of Section 415. The section is entitled "Payments" and purports to prescribe the manner in which federal funds are paid *to the States*. Therefore, it is clear that whatever "adjustments" are authorized under this provision, they are to be accomplished by means of an offset against current or prospective grant fund disbursements to SEA's. The Department's actions in the cases at bar are very much different and it cannot, therefore, invoke the authority of Section 415.

In fairness to the Department, it should be noted that its arguments respecting Section 415 rely heavily on certain statements in the Senate Report on the 1969 Amendments (which first enacted GEPA Section 415 as Section 425), which seem to indicate a much broader remedial power than we have recognized. *See* S. Rep.. No. 91-634, 91st Cong., 2d Sess.

---

[16] Pub. L. No. 90-247, tit. IV, § 425, *as added by* Pub. L. No. 91-230, tit. IV § 401(a)(10), 84 Stat. 170 (1970), *renumbered*, Pub. L. No. 92-318, tit. III, § 301(a)(1), 86 Stat. 326 (1972), *renumbered* Pub. L. No. 95-561, tit. XII, § 1231(a)(1), 92 Stat. 2342 (1978).

83-84, *reprinted at* [1970] U.S. Code Cong. & Ad News 2826.[17] A close reading of the report, however, reveals that the language on which the Department relies, printed under a heading of "REPORTS AND AUDITS," was in fact explanatory of Section 424 of the bill, and that the reference to Section 425 was a typographical error. The committee's remarks concerning Section 425 (now Section 415) are in the immediately preceding paragraph of the report.[18]

Section 424, to which the legislative history quoted in note 17 in fact refers, required grant recipients to maintain appropriate records of Title I expenditures and programs and gave Department officials and mem-

---

[17] The Department quoted to the court the following passage from the report:

> The language of section 425 is based on a recommendation of the Comptroller General respecting retention of records and audits relating to education programs.
>
> Audit reports on title I of the Elementary and Secondary Act have been valuable to the committee in its review of that program. The committee notes that exceptions have been taken to certain expenditures of title I during the initial years of the program and, to the extent this committee has reviewed those exceptions, they appear to well founded. Even though there may be difficulties arising from recovery of improperly used funds, those exceptions must be enforced if the Congress is to carry out its responsibility to the taxpayer.

[18] That paragraph reads:

> GENERAL PROVISIONS
>
> Sections 422, 423, and 425 are general provisions concerning the prohibition of Federal control of education, labor standards, and methods of payment. These three sections are a substitute for the numerous similar provisions scattered throughout present law and obviate the necessity of including similar provisions in any further legislation.

bers of the Comptroller General's staff full access to those records "for the purpose of audit and examination." Although not pressed upon the court, we assume the argument that Section 424, in providing the authority to conduct audits, also authorizes the resolution of audit determinations and that the strong legislative history of the section indicates an intent to utilize refunds as a means of resolution. Such an argument is not unreasonable; in the circumstances of this statutory scheme, however, it is unavailable.

As we alluded to earlier, Title I was a fundamental departure from the traditional federal role in education. Public Law 874, which served as the foundation on which the 1965 ESEA was built, limited federal aid to areas directly affected by local federal activity, especially that activity related to the war effort. *See* S. Rep. No. 2458, 81st Cong., 2d Sess., *reprinted in* [1950] U.S. Code Cong. & Ad. News 4014. We think it likely, in light of the historic underpinnings and the experimental nature of Title I, that Congress desired to receive accurate and reliable information on the program's strengths and weaknesses. That such information was earnestly sought and utilized is reflected by the number and breadth of the ESEA amendments. *See* note 2 *supra*. Despite the committee's acknowledgment that audit reports had been forthcoming in the past, we believe that Section 424 was enacted as a means of assuring the continued flow of information to the Department and Congress.

We find support for our conclusion in the 1978 Amendments to the Act which, although they augmented the Act with Section 185 and its GEPA counterpart Section 452,[19] both of which explicitly author-

[19] Pub. L. No. 90-247, tit. IV, § 452, *as added by* Pub. L. No. 95-561, tit. XII, § 1232, 92 Stat. 2347 (1978) (*codified at* 20 U.S.C. § 1234a (Supp. III 1979)).

ize the Secretary to demand and collect refunds of misspent monies, left in place Section 424 (*codified as amended at* 20 U.S.C. § 1232f (Supp. III 1979)), without significant amendment. Were we to read Section 424 as authorizing the procedures used and the orders issued in the instant cases, not only would we be ascribing to Congress a useless act in enacting Section 185, but we would be construing the Act to contain plain redundancies. Neither course is appropriate.

The Department has been very thorough in marshalling its arguments before this court. Barely a line of legislative history supporting the existence of recoupment authority during the time these funds were received has escaped attention in its oral argument or brief. The States also have made extensive efforts to support their position in the reports and discussion of Congressional committees and members. The parties' assiduousness, however, has failed to provide the requisite legislative history which compels either interpretation of the statute. In view of this void, we look to the terms of the statute itself for the clarity of expression demanded of Congress when States are asked to put at risk substantial rights and benefits in exchange for their participation in a federal grant program. We have studied this statute carefully; we have also closely reviewed the Department's regulations. We cannot say with the necessary firmness of belief that prior to 1978 Congress conferred upon the Department the authority it here asserts against the States. We are constrained, therefore, to deny the statutory power of the Agency to order repayment of the misspent or misapplied funds.

C.

As an alternative source of authority, the Department invokes the common-law right of the Government to recover money and property distributed contrary to law or under a mistake of fact. *See Rex Trailer Co.* v. *United States*, 350 U.S. 148, 151 (1956); *United States* v. *Munsey Trust Co.*, 332 U.S. 234, 239-40 (1947); *Wisconsin Central Railroad* v. *United States*, 164 U.S. 190, 206, 211 (1896). Arguing that federal agencies are free—perhaps obligated—to avail themselves of this remedy to recover misspent funds, the Department cites to *United States* v. *Marion County School District*, 625 F.2d 607 (5th Cir. 1980); *Mt. Sinai Hospital* v. *Weinberger*, 517 F.2d 329 (5th Cir. 1975); and *Utah State Board of Vocational Education* v. *United States*, 287 F.2d 713 (10th Cir. 1961).

Although not willing to concede that a common-law right of recovery exists in the circumstances of these cases, the States argue that even assuming the Department could pursue such a remedy for Title I violations, it would have to do so by instituting an appropriate action in a court of competent jurisdiction. Because all proceedings leading up to the decisions presently under review were conducted at the administrative level, the States contend that those decisions, insofar as they require a refund of misspent monies, are a nullity. In support of their arguments, they cite *School Board* v. *Department of Health, Education and Welfare*, 525 F.2d 900 (5th Cir. 1976).

As evidenced by the citation of authority *supra* at 16-17, there can be no debate concerning the right of the Government "to make contracts and hold and dispose of property, and, for the protection of its prop-

erty rights, . . . resort to the same remedies as a private person." *Rex Trailer Co.* v. *United States*, 350 U.S. at 151. However, where a legislative body provides for liability coupled with a special statutory remedy, "that remedy, and that alone, must be employed." *Pollard* v. *Bailey*, 87 U.S. 520, 527 (1874). *See also National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453, 458 (1974) ("A frequently stated principle of statutory construction is that when legislation expressly provides a particular remedy . . ., courts should not expand the coverage of the statute to subsume other remedies."). The States have presented a strong argument that by providing for the withholding of funds and disapproval of SEA applications, Congress intended to abrogate whatever common-law causes of action the Department may have had to redress noncompliance with the federal Title I scheme. The Department makes an at least equally persuasive argument, grounded in legislative history [20] and an analysis of the operation of the statutory remedies [21] that Congress did not intend that the Department be without a remedy to recover misspent funds. Therefore, it is argued, if the statute does not provide such authority, Congress must have in-

---

[20] The Department especially relies on the enactment, in 1974, of a statute of limitations for recovery of misspent funds. *See* note 10 *supra*.

[21] Withholding and disapproval of applications, it is contended, are effective only to correct current violations of Title I. Once the SEA brings its program into compliance, the withholding must terminate and the application must be approved. Without the availability of a common-law right of recovery, the Agency argues, it is powerless to correct past violations of Title I.

tended to leave the common-law remedies intact. In the circumstances of these cases, we need not now decide whether a common-law right of recovery survived enactment of the ESEA because if such a remedy does exist, the method of distributing Title I monies lends itself to enforcement of that right only by an action in a court of competent jurisdiction.

Of the case relied on by the Department, only *Mt. Sinai Hospital* v. *Weinberger*, 517 F.2d 329 (5th Cir. 1975) involved a wholly administrative utilization of a common-law right of recovery. In *Mt. Sinai*, HEW withheld funds owing to the hospital for past services rendered to Medicare patients. HEW's action was prompted by the agency's determination that, on other occasions in the past, the hospital had rendered services that were not medically necessary but had nevertheless been paid for with Medicare funds. The hospital brought court action seeking an injunction directing the agency to release the funds and to pay them over to the hospital. The district court granted the injunction, holding that HEW's common-law right of recoupment had been abrogated by enactment of the comprehensive Medicare statute. The Fifth Circuit reversed on the abrogation issue.

The remedy of setoff which HEW sought to employ in *Mt. Sinai*, however, is inappropriate in these cases because of fundamental differences between the funding scheme employed by HEW in *Mt. Sinai* and the scheme under Title I. Medicare funds are distributed to participating health care providers by way of reimbursement for services already rendered. Thus, if HHS [formerly HEW] utilizes its common-law right of setoff, which is available to anyone holding funds owing to another from whom a debt is owing, Medicare beneficiaries still receive treatment, but the Government need not pay for those services outside the

program's coverage. The same remedy was used in *Wisconsin Central Railroad* v. *United States*, 164 U.S. 190 (1896), dealing with recovery of illegally disbursed payments for mail carriage by a land grant railroad, and *United States* v. *Munsey Trust Co.*, 332 U.S. 234 (1947), concerning the offset of "cover costs" resulting from the breach of a government construction contract against an amount owing the defaulting contractor from the completion of other contracts.[22] In contrast, the Department uses an advance-funding method of distributing Title I funds, presumably because school districts are unable to function on an anticipated revenue basis. For the Department to attempt to use an offset remedy, therefore, would result in the failure of the school districts to provide Title I services during the year for which funding was withheld. This is obviously unsatisfactory as it defeats Congressional objectives and it means that the intended beneficiaries of the Act—underprivileged school-children—not only suffer when the funds are misapplied but also when the Department attempts to remedy the misapplication.

The Department has not referred us to any case in which a governmental right of recovery was administratively exercised by a means other than setoff and sustained by a court that had analyzed the issue.[23]

---

[22] *See also* Lodge 2424, Int'l Ass'n of Mach. & Aerospace Workers v. United States, 564 F.2d 66 (Ct. Cl. 1977).

[23] The Department's reference to West Virginia v. Commissioner of Education, No. 79-1338 (4th Cir. 1980) (unpublished per curiam) is not helpful, even though that case dealt with an order of the Department resulting from procedures similar to those employed here. The court's opinion fails to reveal that the arguments considered in this opinion were pressed and, in such absence, we will not assume that the Fourth Circuit ruled on the issue that presently confronts us.

We have found only one such case, *Admiral-Merchants Motor Freight, Inc.* v. *United States*, 321 F.Supp. 353 (D.Colo. 1971), and the peculiar facts of that case, coupled with the court's use of equitable estoppel, *id.* at 359, render the case inapposite to the one at bar. Further, the law announced in the case militates strongly against upholding the Department: "[A] legislative tribunal cannot exercise common law or equity jurisdiction unless this authority is expressly granted by the Congress." *Id.* at 359. *See also School District* v. *Department of Health, Education, and Welfare*, 525 F.2d 900 (5th Cir. 1976) (HEW hearing examiner had authority only to determine eligibility of grant recipient, not to order refund or funds dispersed to ineligible grantees).

In the absence of any authority to the contrary, we conclude that the Department, if it retains a common law right to recover misspent Title I funds, may exercise that right only by maintaining a civil action in a court of competent jurisdiction. We note that such a rule assures that the parties to the audit are able to press their arguments concerning the merits of the audit in a judicial forum, either in the Agency-initiated proceedings or in an action seeking to have the Agency remit withheld funds. The Department itself argues to this court that such an opportunity was unavailable to audited parties prior to enactment of the 1978 Amendments. Because neither of the allowable courses were followed in these cases, we may not sustain the orders directing the States to repay the funds determined to have been misspent.

II.

Our decision in these troublesome cases is reached only after carefully weighing the effect it may have

upon a valuable national educational program. Title I is an important cornerstone in the federal aid to education program and, by most accounts, it is proving reasonably successful in securing the advantages of education for the seriously disadvantaged. Misapplication of funds, even though it occurs in a good-faith effort to comply with complex regulatory requirements, detracts from the effectiveness of the program as a whole. It cannot be condoned or dismissed lightly. Administrative agencies, however, are purely creatures of statute, and their authority is statutorily circumscribed. To allow an agency to assume powers that it considers appropriate in carrying out its duties but which have not been allotted to it by Congress would attribute legislative powers to the executive branch and disturb the balance in our tripartite system of government. More important, perhaps, would be the absence of due process in a system where agencies charged with administering the multitude of federal grant programs were free to augment or abridge the rights and obligations forming the contractual basis of the grantees' participation. Title I participants who have received funds after the effective date of the 1978 Amendments have been advised by Congress that they will be held responsible in administrative proceedings with a right of judicial review for Title I funds that are misapplied. Requiring less is simply inconsistent with our concept of fairness.

We therefore hold that an administrative agency has no authority to order repayments of funds misapplied or misspent by federal grant participants unless Congress, at the time the funds are received, has declared its intention to empower the agency to exercise such a remedy. In the absence of Congres-

sional authority, the remedy exists, if at all, only at common law. We further hold that if an agency employing an advance-funding scheme such as that provided for in Title I relies on a common-law right to recover misspent funds, it may do so only by maintaining a civil action in a court of complete jurisdiction.

Accordingly, the petitions for review will be granted and the orders of the Department will be reversed and the cases remanded with instructions to vacate the orders requiring a repayment by petitioners of previously received Title I funds.[24]

---

[24] Because we do not reach the issue of the regularity of the proceedings at the agency level, the Department's motion to strike the affidavit of William M. Dallam, appended to petitioner Pennsylvania's reply brief, will be granted.

A. LEON HIGGINBOTHAM, *Circuit Judge*, Concurring.

I concur in the holding of the court, specifically, that the Department was not empowered by statute to order the states to repay the amounts that were determined to have been misspent.

I cannot agree that the issue of what common law remedies the Department may have had is properly before us, because it is clear that no such remedies were exercised by the Department in these cases. I therefore believe that the court's discussion of the scope of the Department's setoff remedy is dictum.

With that understanding, I concur.

A True Copy:

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

APPENDIX C

DEPARTMENT OF HEALTH, EDUCATION AND WELFARE

EDUCATION APPEAL BOARD

Docket No. 14-(29)-76

APPEAL OF

THE STATE OF NEW JERSEY
TITLE I, ESEA

DECISION

Appearances: Mark Schorr, and Jane Sommer for the State of New Jersey; Philip H. Rosenfelt and Robert Arnot for the Deputy Commissioner of Elementary and Secondary Education.

I. *Preliminary Statement*

On June 11, 1976 the Deputy Commissioner for the Bureau of Elementary and Secondary Education, Department of Health, Education and Welfare ("Deputy Commissioner") issued a final determination letter to the New Jersey State Department of Education ("New Jersey" or "New Jersey SEA") demanding a refund in the amount of $1,161,917 to satisfy certain claimed deficiencies relating to expenditures by New Jersey through its Newark Local Education Agency ("Newark" or "Newark LEA") of Title I funds during the school years 1970-71 and 1971-72.

The Deputy Commissioner's claimed refunds are based on the H.E.W. audit agency's findings of June 20, 1975, which are summarized in Enclosure No. 1 to the Deputy Commissioner's letter of June 11, 1976, as follows:

a. $91,266 in Title I funds were improperly spent during the 1970-71 school year at the Lafayette

School, which was found to be ineligible for such funds on the basis of the low-income percentage shown on the face of Newark's application to the New Jersey SEA.

b. $41,102 in Title I funds were improperly spent during the 1970-71 school year at 10 Newark schools because these schools were not listed in the LEA's application as eligible for Title I funds.

> (By reason of the application of the federal statute of limitations, 20 U.S.C. § 884 (Supp. IV 1974), it has been stipulated that all but $1,674 have been eliminated from the above two claims. Attempts at settlement failed; and the parties have requested the panel to determine whether the Deputy Commissioner is entitled to the reduced claim for $1,674.)

c. $1,029,630 in Title I funds were improperly spent during the 1971-72 school year because the method used by the Newark LEA to determine the eligibility of attendance areas deviated from the applicable Title I regulations, and particularly § 116.17 (d) thereof. Ten elementary schools and three secondary schools were found to have been ineligible.

On May 12, 1977, the undersigned Panel of the Education Appeal Board (formerly the Audit Hearing Board) met to consider New Jersey's appeal at a pre-hearing conference. The points agreed on at this conference were summarized in a pre-hearing conference statement issued by the Panel on June 29, 1977. Pursuant to the schedule adopted by the Panel at that pre-hearing conference, counsel then exchanged written interrogatories and responses were made.

On September 2, 1977, New Jersey filed a motion to compel answers to certain of its interrogatories to

which the Deputy Commissioner had objected and the Deputy Commissioner responded to this motion.

The Panel considered the papers submitted and by a memorandum opinion and order dated February 10, 1978, held that it does not have authority to compel discovery, including answers to interrogatories, and that the Panel's role is limited to encouraging the parties to undertake voluntary discovery.

The Panel went on to advise the parties with respect to whether several of the New Jersey interrogatoreis objected to by the Deputy Commissioner could, in the Panel's opinion, be answered and to what extent. This, however, was simply informal advice to counsel for the parties.

On March 31, 1978, counsel for both parties filed a joint pre-hearing memorandum, together with New Jersey's statement of factual and legal contentions and the Deputy Commissioner's statement of the issues presented and his position thereon. In their joint pre-hearing memorandum, counsel for the parties indicated that neither party requested an evidentiary hearing at that time, *i.e.*, March 1978.

On April 17, 1978, the Panel adopted the briefing schedule that had been jointly proposed by both parties. The following briefs were filed on the in-indicated dates:

a. On June 2, 1978, New Jersey filed its main brief together with an affidavit of Bernard J. Brandwene and an appendix and certain exhibits.

b. On August 4, 1978, the Deputy Commissioner filed its main brief, together with certain exhibits, including Exhibit F, the affidavit of Alan Bergman.

c. On September 11, 1978, New Jersey filed a letter reply brief, and on November 9, 1978, New Jersey filed a supplemental affidavit of Bernard J. Brandwene.

d. On September 12, 1978, New Jersey filed a motion to suppress the affidavit of Alan Bergman and the Deputy Commissioner responded.

e. On January 9, 1979, the Deputy Commissioner filed a supplemental affidavit of Alan Bergman.

f. On January 10, 1979, the Deputy Commissioner filed comments concerning the supplemental affidavit of Mr. Brandwene.

The Panel considered New Jersey's September 12, 1978 motion to suppress and by memorandum order dated March 8, 1979, denied it. At the same time, it noted that neither party had requested an evidentiary hearing and certain other matters. In its memorandum the Panel requested that counsel for the parties address the following principal issues at oral argument:

(1) Whether the Commissioner of Education is without jurisdiction to compel New Jersey to refund the Title I monies allegedly improperly spent.

(2) Whether the New Jersey SEA, in approving the Newark LEA's 1971-72 Title I project application, failed to comply with the then prevailing regulations establishing project eligibility.

(3) Whether New Jersey's recalculation of low income percentages made after the acceptance of the project application by the SEA and approval of the Office of Education of the grant award are relevant to this appeal.

(4) If so, whether the method used by New Jersey in making its recalculation meets the then applicable Office of Education regulations and program criteria for Title I program awards.

(5) If so, whether such calculation supports New Jersey's contention that the grant was properly made and no refund is required.

(6) Assuming that the answer to any of the foregoing three questions is in the negative, is there any other ground whereby the grant award to the Newark LEA may be supported, including possible designation of the Newark LEA as a district-wide Title I target area?

With respect to all but the second issue, the parties stipulated that the issues have been joind. With respect to the second issue, the New Jersey SEA does not contend that Newark's LEA-71-72 Title I application complied with the then prevailing regulations establishing project eligibility.

Counsel for the parties ably and thoroughly addressed the principal issues at an oral argument on June 21, 1979. At this argument the Panel rejected counsel for New Jersey's request to introduce a further supplemental affidavit of Bernard Brandwene, an accountant for New Jersey, in view of the lateness of the offer and New Jersey's prior agreement to waive an evidentiary hearing. We will now consider the various issues.

II. *Findings of Fact and Conclusions*

A. *Deputy Commissioner's reduced claim for $1,674 refund for the 1970-71 school year.*

As noted above, the parties have stipulated that all but $1,674 of claim "a" ($91,266) and claim "b"

($41,102) have been eliminated by application of 20 U.S.C. § 884 (Supp. IV 1974), the federal statute of limitations. At oral argument counsel for New Jersey submitted the question of its obligation to refund the $1,674 on the bases of points 1 and 4 of its principal brief, filed June 2, 1978, and counsel for the Deputy Commissioner submitted on the basis of Appendix A to its principal brief filed August 4, 1978, which addresses points 1 and 4 above. Point 1, which challenges the Commissioner's authority to require SEA's to refund Title I funds determined to have been improperly spent, is resolved against New Jersey in Part B, below. Point 4, which contends that Newark could have been declared a district-wide Title I target area during the 1971-72 school year, is not relevant to the audit findings relating to the 1970-71 year because New Jersey does not include any evidence concerning the variance in low-income percentages in Newark during the latter year. Nor do we see how such a conclusion can be deduced from the evidence relating to the 1971-72 year with regard to Newark's being a district-wide target area, which we in fact reject below. (See *infra* paragraph G.) Hence, the Deputy Commissioner's reduced claim for the $1,674 refund is sustained.

B. *Whether the Commissioner of Education is without jurisdiction to compel New Jersey to refund Title I monies allegedly improperly spent.*

New Jersey claims that the Commissioner is without authority to seek refund of monies allegedly misspent under the Title I grant from the U.S. Office of Education. In principal support of this claim, New Jersey asserts that the Commissioner's remedies under Title I are limited to his power to withhold

funds prospectively (20 U.S.C. 241j). The cited statute provides that, whenever the Commissioner finds a failure to comply substantially with any assurance contained in an SEA's application, he may notify the SEA that further payments will be withheld until he is satisfied that there is no longer any such failure to comply. New Jersey argues that an administrative agency must keep within the powers expressly conferred by law, that its jurisdictional grant should be strictly construed, and that the power to demand refunds cannot be implied from the purpose of the basic legislation, which is to pay-over monies to SEAs to meet the special educational needs of educationally deprived children. New Jersey further argues that the Congress knows how to grant express administrative powers to recoup allegedly misspent funds as, for example, in 20 U.S.C. § 631, dealing with construction of urgently needed school facilities in federally impacted areas. Further, New Jersey cites Section 9(b) of the Administrative Procedure Act (5 U.S.C. § 558(b)) which provides that "a sanction may not be imposed . . . except within jurisdiction delegated to the agency and as authorized by law." Thus, New Jersey concludes that because no authority is expressly set out in the enabling statute and none can reasonably be attributed to any conceivable educational purpose, the authority does not exist and the Commissioner is without jurisdiction to require a refund.

The Deputy Commissioner, in response, finds statutory authority for refund proceedings in Section 435 of the General Education Provisions Act, 20 U.S.C. § 1232d, which authorizes the Commissioner to make "adjustments on account of overpayments or underpayments as the Commissioner may determine." In

response to New Jersey's assertion that nothing in the legislative history of Title I suggests that the Commissioner has the power to compel refunds, the Deputy Commissioner cites the Senate report accompanying Section 435, which notes that in prior years audit exceptions had been taken to certain Title I expenditures and that "they appear to be well founded," and "must be enforced if the Congress is to carry out its responsibility to the taxpayers." Sen. Rep. No. 91-634, 91st Cong. 2d Sess. 83-84 (1970). The Deputy Commissioner also finds Congressional intent in the five-year statute of limitation provision enacted in 1974 (20 U.S.C. § 884), in that there would have been no purpose in limiting recoupment to a five-year period prior to receipt by the SEA of final written notice that certain payments were unauthorized if in fact there were no authority in the Office of Education to recoup those payments during the five-year period. The Deputy Commissioner also argues that the Commissioner has a common law right to recoup allegedly misspent monies.

The Panel has given careful consideration to the pros and cons of this basic jurisdictional challenge. We believe that the issue may not have been free from doubt prior to the time that Congress enacted the 1974 statute of limitations. But by that action Congress must have recognized the Commissioner's authority to recoup when it decided to put a time limitation on that very authority. While this is not an express delegation of jurisdiction, it comes close enough, in our view, to satisfy APA Section 9(b). It also indicates a legislative intent expressed with respect to Title I programs which precedes the Deputy Commissioner's final determination letter of June 11, 1976. This issue has been considered and similarly resolved in the Com-

missioner's favor by at least three other panels,* and may ultimately be raised and determined in an appropriate judicial forum. For these reasons, we conclude that the Commissioner is not limited to withholding of future funds but may recover funds improperly spent within the applicable limitation period.

C. *Whether the New Jersey SEA, in approving the Newark LEA's 1971-72 Title I project application, failed to comply with the then prevailing regulations establishing project eligibility.*

As noted above, the New Jersey SEA admits it did not meet the Title I requirements for determining the eligibility of school attendance areas for Title I funding when it approved Newark LEA's 1971-72 project application with respect to 13 Newark schools. Under Section 142(a) of Title I of the basic statute (20 U.S.C. §241f(a)), a state desiring to participate in the Title I program must give an assurance to the Office of Education ("OE") that it will only approve LEA projects which meet Title I requirements and that it will enforce all obligations imposed on LEAs under 45 C.F.R. § 116 et seq. The New Jersey SEA gave OE such an assurance.

1. *The basic eligibility standards for Title I grants.*

The basic eligibility standard for Title I grants to LEAs at the time in issue (20 U.S.C. § 241e(a)(1)) was that payments under the Title be used for proj-

---

* *Appeal of the State of New Mexico*, Docket No. 5-(20)-76 (Decision, August 17, 1979); *Appeal of the State of Pennsylvania* Docket No. 10-(25)-76 (Ruling on Prehearing Motion, May 9, 1978), *Appeal of the State of Texas*, Docket No. 7-(9)-74 (Decision, May 10, 1976).

ects designed to meet the special educational needs of educationally deprived children in "school attendance areas having high concentration of children from low-income families." Implementing this provision, § 116.17(d) of the Title I regulations (45 C.F.R. 116.17 (d)) interpreted the quoted statutory language as including: (1) attendance areas in which the number of children from low-income families is as large as, or larger than, the average number of such children in the various attendance areas of the school district; and (2) attendance areas in which the percentage of children from low-income families is as large as, or larger than, the percentage of such children in the school district. Section 116.17(d) also permitted an entire school district to be designated as eligible but only when there was no wide variance in the number or percentage of children from low-income families. For convenience, a copy of § 116.17(d) is attached to this Decision.

In addition, OE published Program Guide No. 44 (issued March 18, 1968) which provided additional instructions for selecting eligible attendance areas. In brief, the Guide provided that for each "attendance area" data must be obtained on (a) the total number of children who, according to their ages, are *eligible* to attend the public school serving that area and (b) the number of such children who are from low income families. Further, it provided that in all cases the number of children considered *eligible* to attend a particular school consists of all children of the appropriate ages, including children attending private schools and children who have dropped out of school.

In addition, the Guide suggested a number of sources of data to determine the number of children from low income families, and primarily two sources:

1. the number of children in families receiving Aid to Families with Dependent Children ("AFDC"), and
2. the number of children receiving free lunches.

It further indicated that housing, health or employment statistics could also be used but that whatever data were used had to be used uniformly throughout the applicant's school district.

Finally, the Program Guide provided a special method for ranking of attendance areas where the schools do not have well defined attendance area boundaries.

2. *The Newark LEA's method of computing low-income percentages listed on its 1971-72 Title I project application admittedly violated the requisite eligibility requirements.*

In determining the eligibility of attendance areas for the 1971-72 school year, the Newark LEA stated in its Title I application that it had relied on one source, the AFDC statistics supplied by the Essex County Welfare Board. Using this source, and employing the following ratio it arrived at a district-wide low-income ratio of 33.9% (32,352 AFDC children divided by the total school age children population of 95,780).

$$\frac{\text{Total Number of Children from AFDC Families in All Attendance Areas}}{\text{Total Number of Children Considered Eligible to Attend Public Schools Serving All Attendance Areas}} = \text{Percentage of Children from Low-Income Families}$$

This method complied with 45 C.F.R. 116.17(d).

Next, under § 116.17(d), the eligibility of a school attendance area is dependent on the relationship between (a) the total number of children *eligible to attend the public school* serving the attendance area, including those attending private schools and those

who had dropped out of school and (b) the number of such children from low-income families. For individual school attendance areas (and as a corollary to the method the LEA used to compute the district-wide low-income percentage) this relationship can be expressed as the following ratio:

$$\frac{\text{Total Number of Children from Low-Income Families in the School Attendance Area}}{\text{Total Number of Children Considered Eligible to Attend the School}} = \text{Percentage of Children from Low-Income Families in the School Attendance Area}$$

However, the Newark LEA did not use this ratio to compute the low-income percentage for the individual school attendance areas. Because of the incompleteness of the available AFDC statistics (which omitted children attending private and special education schools), the LEA decided to use an alternative ratio permitted by Program Guide 44 under certain conditions. The Guide recognized that in those instances where schools may not have ". . . well-defined attendance area boundaries or receive numbers of children from outside the areas that have been designated for those schools . . .," it may be necessary to use a different ratio, which bases the ranking of the attendance areas for such schools on the ". . . percentage or number of children actually enrolled in [rather than eligible to attend] these schools. This ratio can be expressed as follows:

$$\frac{\text{Total Number of Children from Low-Income Families Enrolled in a Specific School}}{\text{Total Enrollment in a Specific School}} = \text{Percentage of Children from Low-Income Families Enrolled in the Specific School}$$

Although the above ratio was not applicable to Newark, which had well-defined attendance areas, the

HEW auditors recognized that Newark had used it because the incompleteness of the AFDC statistics left no other reasonable approach and acknowledged that it was "a reasonable alternative under the circumstances." But the auditors went on to state that, instead of following the above alternative ratio, the Newark LEA:

> . . . devised hybrid ratios which deviated from the method specified in the program guide. The results were unacceptable since there were no direct relationships between the component elements. For each public elementary school, [Newark] included in the numerator the number of [AFDC] children enrolled in that school as well as the total number of [AFDC] children residing in the school attendance area who were enrolled in junior and senior high schools. However, [Newark] limited the data in the denominator to the total enrollment of the elementary school. There was therefore no meaningful relationship between the data shown in the ratio, namely the total [AFDC] statistics for the attendance area and the elementary school enrollment. Lacking this correlation, the ratio had basic mathematical flaws which tended to inflate the low-income percentage for individual elementary school areas and thus to increase improperly the number of eligible attendance areas.

(Final Audit Report, pages 10-11; Tab C, pages 10-11)

Thus, while the Newark LEA used the proper *denominator* (total enrollment in a particular school), it also, as it has admitted, improperly inflated the *numerator* by including not only the AFDC children

who were enrolled in the particular elementary school but also AFDC children residing in that school's attendance area who were enrolled in junior and senior high schools.

Correctly recalculating the low-income percentages for each of the 41 elementary schools presented as eligible in Newark's Title I application on the basis of the above alternative method, the auditors found that 10 of the 41 schools had low-income percentages that were lower than the district-wide average of 33.9 percent. Thus, these ten schools were ineligible for Title I funding. The Panel accepts the auditors' findings, which are consistent with the underlying evidence.

Similarly, the auditors found that Newark had used a different (and also incorrect) method to compute the low-income percentages for the junior and senior high schools. This method involved, as New Jersey has acknowledged, the LEA computing the low-income percentages for junior and senior high schools by averaging the low-income percentages of the "feeder or pipe-line" elementary schools. New Jersey has also recognized that it approved the LEA's 1971-72 Title I project application despite the fact the application contained these errors. In its initial brief, (p. 19) New Jersey acknowledges that

> The flaw in the initial formula was that it tended to inflate low-income percentages in attendance areas in that its numerator consisted of all low-income students in an area while its denominator described only elementary school enrollment.

On the basis of this admitted "flaw" in the formula used, three of the junior/senior high schools were found to be ineligible for Title I funds during the 1971-72 project year.

D. *Whether New Jersey's recalculation of low income percentages made after the acceptance of the project application by the SEA and approval by the Office of Education of the grant award are relevant to this appeal.*

It is New Jersey's position that the recalculations submitted in the affidavit and first supplemental affidavit of Bernard Brandwene, an accountant, support its contention that the grant was properly made and no refund is required, with the exception of the Garfield School and the Hawkins School ($18,779), which New Jersey concedes remain ineligible even under Mr. Brandwene's recalculations. New Jersey further recognizes that "these calculations are in fact an acknowledgment of the fact that there were irregularities in the original grant approval process," Transcript of Oral Argument, June 21, 1979, (p. 26). The Deputy Commissioner contends the three secondary schools (Clinton Place, Weequahic and East Side), for which $157,878 of Title I funds were spent, and for which New Jersey has provided no recalculations should also be excepted. Thus, even if the Panel were to accept the recalculations, $342,657 in Title I funds may have been improperly allocated.

Putting to one side the merits of the recalculations, the threshold question is whether they are relevant to this appeal.

New Jersey advances what is essentially an equitable argument: in justifying what it has done, a state should be able to rely on any evidence relevant to the Board's primary mission, which is to determine whether the Title I funds were used in schools which, in fact, met the eligibility requirements of the federal regulations, and thus met the special educational needs of educationally deprived children, the underlying

policy of Title I. New Jersey refers to the decision of another panel which admitted "substantially similar *ex post facto* evidence" as instructive. *Appeal of California*, Docket No. 4-(15)-75 (Decision, July 6, 1977). In that case, the original application of a California School District for a Title I program clearly indicated on its face that one of the elementary schools to be included was not eligible: *i.e.*, that the application met neither of the 45 CFR § 116.17(d) requirements, since both the *percentage* and the *absolute* number of children from low-income families in the school were *below* the district-wide average. During the appeal, California submitted supplementary evidence to the panel which indicated that the original application was erroneous and that the school was in fact eligible to participate in the District's Title I program. The panel recognized that the situation confronted it with a difficult choice. On the one hand, the District's application was clearly defective, the SEA had incorrectly approved it, and no steps were taken to correct the error until after the project year was completed; the state had also failed to follow the obvious and clearly defined federal regulations in the application approval process and therefore it was apparent that the relevant portion of the Title I award should be refunded to the Federal Government. On the other hand, since the school was in fact eligible to receive Title I funds, no misuse of the funds was really involved. "With some misgivings," the panel decided no refund should be required for the following reasons: (1) the panel recognized that for the goals of this major federal grant program to be reached, it was necessary that specified procedures be followed and explicit information supplied; (2) occasional failures to do so, which could be described as

"unavoidable human error," were to be expected; (3) if such errors occurred regularly, they became a pattern of conduct which could be viewed as "administrative negligence"; (4) such a pattern could jeopardize the very legislative purpose of this multi-billion dollar federal education program; (5) here, since the panel was confronted with one isolated case, it could not conclude that serious "administrative negligence" existed with respect to the state's review of school district applications generally. Accordingly, the California panel concluded that the mistake involved was a technical one, the result of an isolated human error, and that no repayment should be required.

In this case, the Deputy Commissioner counters New Jersey's argument with several points. Perhaps the most persuasive is that if the Panel is to accept after-the-fact documentation and recalculations, the review function could be rendered meaningless; it would in effect convert the Panel into an auditor, which is not its designated function; further, the HEW auditors could not conduct an effective audit if the grantees were permitted, years after the funds had been spent, to use new methods for computing attendance area eligibility. The Deputy Commissioner also seeks to distinguish the California appeal by pointing out that it involved only one (not thirteen as is the case here) school in the district in question, and that it involved only a computational error, not the use of an improper eligibility formula that inflated the low-income percentages for all school attendance areas in the entire school district.

We do not accept the Deputy Commissioner's basic position that under *no circumstances* should a panel consider after-the-fact evidence. The California appeal is a case in point: a single instance involving a

technical (in this case, computational) error. We are not, however, convinced that the New Jersey multi-school situation fits within the California rationale. However, in view of the conclusions we reach below regarding the merits of New Jersey's recalculations, we need not reach the question of their relevance to this appeal.

E. *Assuming New Jersey's post-hoc recalculations are relevant to this appeal, does the method used by New Jersey in making its recalculations meet the then applicable Office of Education regulations and program criteria for Title I program awards?*

New Jersey contends that its recalculations of low-income percentages for the ten elementary schools in question used the method suggested in Program Guide #44:

> "The flaw in the initial formula was that it tended to inflate low-income percentages in attendance areas in that its numerator consisted of all low-income students in an area while its denominator described only elementary school enrollment. In contrast, the ratio used for the recalculations had a numerator comprised of all low-income children from the area while the denominator was made up of *all* children from the attendance area enrolled in elementary, junior high, *and* senior high schools." New Jersey's Initial Brief, pp. 19-20.

In making its recalculations, New Jersey claims to have relied on the following paragraphs of the Program Guide:

"Some schools have no well-defined attendance area boundaries or receive numbers of children from outside the areas that have been designated for these schools. It may be necessary to base the ranking of the attendance areas for such schools on the percentage or number of children from low-income families actually *enrolled* in those schools while recognizing that other children, as explained below, will be included in the 'target population' if the area is found to have higher than average concentration of children from low-income families."

"The purpose of the attendance area requirement is to identify the 'target populations' of children who are to be considered for participation in Title I activities on the basis of educational deficiency and need for special services. Thus, *for schools without well-defined boundaries or where children have been transferring in or out on open enrollment or freedom-of-choice plans, the* 'target population' should include (a) all of the children who are attending the particular public school which on the basis of enrollment has a high concentration of children from low-income families; (b) children who have been attending that school; and (c) children who would be attending that school if they were not attending a private school or another public school under a freedom-of-choice, open enrollment, or another plan designed to bring about desegreation." (Sa 43) (emphasis added)

Based on its interpretation of the above paragraphs, New Jersey considered data based on the *total* number of children eligible to attend the public schools serving

the various attendance areas and the *total* number of low-income children from the respective areas.

New Jersey's reliance on the above paragraphs appears misplaced. As discussed above, the Program Guide includes an alternative method for ranking attendance areas where the schools do not have well-defined attendance boundaries. Although, in the opinion of the HEW auditors, the Newark LEA had well-defined attendance boundaries, they still found it appropriate for New Jersey to use the alternative method of ranking. But, as the Panel reads the above paragraphs, the Guide's intent was that under the alternative method schools were to be ranked on the basis of the percentages of low-income children enrolled in each particular school.

As previously stated, the alternative method in the program guide can be stated:

$$\frac{\text{Total Number of Children from Low-Income Families Enrolled in a Special School}}{\text{Total Enrollment in a Specific School}} = \text{Percentage of Children from Low-Income Families}$$

In its original calculation New Jersey had included in the numerator not only the number of AFDC children enrolled in that particular school but also the total number of AFDC children residing in that school's attendance area enrolled in junior and senior high schools.

In its recalculatins of low-income percentages, instead of correcting the numerator to include only those children from AFDC families enrolled in a particular elementary school, New Jersey has added an improper denominator to the LEA's previous improper numerator, *i.e.*, both the numerator and the denominator incorrectly included children enrolled in junior and senior high schools. This "aggregate enrollment" does not appear to be authorized by either 45 CFR 116.17(d) or Program Guide #44.

As stated in the affidavit of Alan Bergman, an HEW auditor, the second "hybrid" ratio had the following inflationary effect:

> The method used by the SEA to recalculate eligibility (combining enrollment data from junior and senior high schools with enrollment data from the individual elementary school) had the effect of inflating the low-income percentages for all but one of the individual elementary schools in question. The SEA's method had this effect because the junior and senior high schools had higher percentages of low-income enrollment than the elementary schools, as shown below:
>
> | | |
> |---|---|
> | Percentage of low-income enrollment for the ten elementary schools in question | 23.8* |

* These low-income percentages were calculated by dividing the total AFDC enrollment (for each category of schools) by the total enrollment in that category. The statistics used in making these calculations were taken from the LEA's 1971-72 project application and the listing of AFDC enrollment statistics that was furnished to the LEA by the Essex County Welfare Board (a copy of this AFDC listing is attached as Exhibit A).

> | | |
> |---|---|
> | Percentage of low-income enrollment for the junior high schools included in the SEA's recalculations | 50.9 |
> | Percentage of low-income enrollment for the senior high schools included in the SEA's recalculations | 35.2 |

By including the junior and senior high school enrollment data (which had higher concentrations of low-income students) the recalculated elementary school percentages were inflated as shown below:

Elementary School	The 1971-72 low-income enrollment percentage for the individual school attendance area based on the AFDC and enrollment statistics and as computed by the HEWAA auditor	The 1971-72 low-income enrollment percentage for the school attendance as recomputed by New Jersey SEA
Madison	28.8	39.7
Newton St.	31.5	42.8
So. 17th St.	33.5	40.3
Central Ave.	29.4	41.4
Burnet St.	30.2	39.0
Waverly Ave.	31.9	37.2
Franklin	32.4	34.8
M. Garvey	22.9	36.1
Garfield	20.6	26.0
Hawkins	30.3	25.9

In summary, in combining enrollment data from junior and senior high school with enrollment data from individual elementary schools New Jersey employed an impermissible method. By building the junior and senior high school enrollments, which had higher concentrations of low-income students, into the ratio, New Jersey inflated the elementary school low-income percentages so that eight of the ten originally disqualified schools became qualified. New Jersey's method of recalculation is unacceptable.

F. Assuming New Jersey's post-hoc recalculations are relevant to this appeal, do such recalculations support New Jersey's contention that the grant was properly made and no refund is required?

Based on the foregoing analysis, the Panel's answer to this question must be "no."

G. *Assuming that the answer to any of the foregoing three questions is in the negative, is there any other ground whereby the grant award to the Newark LEA may be supported, including possible designation of the Newark LEA as a district-wide Title I target area?*

New Jersey contends that "under regulations applicable in 1971 and consistent with the clearly expressed intent of Congress, the whole of the Newark school district could have been considered educationally disadvantaged so as to be a Title I area." Initial Br. p. 22, see pp. 22-28.

At the time of the Newark's submission of its 1971-72 application, 45 CFR § 116.17(d) provided in part:

> . . . In certain cases, the whole of a school district may be regarded as an area having a high concentration of [*children from low-income families*] and be approved as a project area, but only if there are no wide variances in the concentrations of such children among the several school attendance areas in the school district.

Newark did not apply under the above "no wide variance" rule to have the New Jersey SEA declare the entire Newark school district eligible for Title I services. Nor did New Jersey, when it approved Newark's 1971-72 application, determine that Newark qualified as a "no wide variance" district.

Nonetheless, New Jersey now contends, for the first time, that the Newark LEA was in fact so qualified. New Jersey first points to certain legislative history, relevant to Title I of the ESEA of 1965 and in particular to a 1965 Senate Committee Report which stated, inter alia: "There may be circumstances where a school system is basically a low-income area and the

best approach in meeting the needs of educationally deprived children would be to upgrade the regular program." Senate Rep. No. 146, 89th Cong., 1st Sess., reprinted in [1965] U.S. Code Cong. & News 1454. New Jersey next refers to a 1966 House Labor and Education Committee Report reaffirming this position:

> *"We specifically pointed that there may be circumstances where a whole school system is basically a low-income area and in which the best approach might be to upgrade the whole school system.* The first year programs involving a general upgrading of whole school systems were discouraged by the Office of Education. The construction of facilities to house Title I programs was permitted only sparingly. This restricted approach was necessitated by limited funds. In the next two years, especially in fiscal year 1968, more funds will be available and more children will be included in Title I programs. It is expected that more general upgrading of school systems and more construction will be permitted. *It is the feeling of the Committee that when 30 or 40 percent of the children in the district are from low-income families, all of the children in the district could be considered disadvantaged and the whole school system could be upgraded."* House Report No. 1814, 89th Cong., 2d Sess., reprinted in [1966] U.S. Code Cong. & Ad. News 3846 (emphasis added).

New Jersey claims that the district-wide low-income percentage for Newark for school year 1971-72 (33.9 percent) fits this model. Finally, New Jersey emphasizes that the narrative portion of the 1971-72 application shows Newark to have been uniformly disad-

vantaged in other important respects, citing high unemployment (14%), the highest percentage of slum housing in the nation, the highest incidents of crime, and the second highest birth rate. Also, in 1970-71 Newark had the highest population turnover in the nation, mobility rates reaching as high as 80 percent for schools in the Title I area. Hence, the Newark LEA had no choice but "to assume high concentrations of low-income families in all attendance areas and to attempt to spread the benefits of Title I as broadly as possible to assure that most educationally deprived children would be served." Initial Br. p. 25

The Deputy Commissioner answers New Jersey as follows:

1. Newark did not seek, under the "no wide variance" rule, to have the New Jersey SEA declare the entire Newark school district eligible for Title I services. Nor did New Jersey, when it approved Newark's application, make such a determination. Therefore it is irrelevant whether the Newark LEA could have qualified had it made such a request.

2. Even if the Newark LEA had made such a request in its 1971-72 project application, it clearly would not have qualified as a "no wide variance" district.

3. The "no wide variance" rule, 45 CFR 116.17(d), begins: "In certain cases the whole of a school district . . ." etc. "In certain cases" is left undefined, allowing LEAs to make these determinations by applying a reasonable standard of "no wide variance" subject to the approval of the SEA.

4. Since Newark's 1971-72 application shows a variance in low-income percentage from a high of 84.7 percent to a low of 10 percent, the Newark LEA's variance during the period in question was 74.7 percent. Under no conceivable interpretation of the "no wide variance" rule could a variance of 74.7 percent be deemed acceptable. Hence, Newark never could have qualified.

5. With respect to the statement from the 1966 House Labor Committee report (on which New Jersey relies) that "when 30 or 40 percent of the children in the district are from low-income families all of the children in the district could be considered disadvantaged," such legislative statement has no relevancy to Newark's 1971-72 Title I project. Neither the Title I statute nor the Title I regulations at the time provided for such an exception and OE did not consider this single statement an adequate basis for issuing a new regulation or amending the "no wide variance" rule since it was inconsistent with the basic Title I policy of meeting the special educational needs of only educationally deprived children.*

Having carefully considered both New Jersey's arguments and the Deputy Commissioner's counterarguments, the Panel has concluded that under the then applicable regulations the whole of the Newark school district could not have been considered educationally disadvantaged so as to come within the "no wide variance" rule and so as to be designated a district-wide Title I target area.

III. *Summary*

Based on the foregoing recitals and the record made in this proceeding, it is the conclusion of the Panel

---

* Since the Board is not authorized to determine whether the regulations are consistent with the statute and the expressed legislative intent, the Panel must apply the regulations on the assumption they are valid.

that New Jersey should make the following payments to the U.S. Office of Education:

1. $1,674 in Title I funds relating to items a. and b. of Enclosure No. 1 to the Deputy Commissioner's letter of June 11, 1976.

2. $1,029,630 in Title I funds relating to item c. of Enclosure No. 1 to the Deputy Commissioner's letter of June 11, 1976.

Pursuant to Sections 100e.81 and 100e.82 of the interim federal regulations establishing procedures for the Education Appeal Board (44 Fed. Reg. 30528, May 25, 1979), this Decision is transmitted to the Commissioner and to the parties, and each party is given notice that it may submit written comments thereon to the Commissioner within a period of twenty-five (25) calendar days from receipt of the Decision. This Decision shall become the final decision of the Commissioner unless, within sixty (60) days after the State of New Jersey's receipt of the Decision, the Commissioner modifies or sets aside the Decision.

ALOYSIUS B. MCCABE
ROBERT MILLER
FRANKLIN M. SCHULTZ
Education Appeal Board Panel

By /s/ Franklin M. Schultz
FRANKLIN M. SCHULTZ
Chairman

Dated: February 19, 1980

APPENDIX D

[SEAL]

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
Office of Education
Washington, D.C. 20202

May 7, 1980

CERTIFIED MAIL
Honorable Fred G. Burke
Commissioner of Education
State Department of Education
Trenton, New Jersey 08625

Reference: Appeal of the State of New Jersey
Docket No. 14-(29)-76
Audit Control No. 50006-02

Dear Commissioner Burke:

A copy of the Panel's decision in the above-referenced appeal was sent to New Jersey on February 27, 1980, and received March 4, 1980. It is my duty to inform you that the Panel's decision, after the appropriate period for comment and review, now stands as the final decision of the U.S. Department of Education. In its decision, the Panel ruled that New Jersey should refund $1,031,304 to the Department of Education. Appropriate authorities within the Department will be in touch with you at an early date to discuss the method of repayment of the funds in question.

These proceedings before the Board now are closed.

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE THIRD DISTRICT

No. 80-1991

STATE OF NEW JERSEY,
DEPARTMENT OF EDUCATION, PETITIONER

v.

SHIRLEY HUFSTEDLER, SECRETARY OF
EDUCATION, UNITED STATES DEPARTMENT
OF EDUCATION, RESPONDENT

ON PETITION FOR REVIEW OF DECISIONS OF
THE UNITED STATES DEPARTMENT OF EDUCATION

ON REMAND FROM THE SUPREME COURT OF
THE UNITED STATES

Present: ADAMS, HUNTER and HIGGINBOTHAM, *Circuit Judges*

JUDGMENT

This cause came on to be heard on the record from the United States Department of Education and was argued by counsel May 18, 1981. By judgment entered October 13, 1981, the Court granted the petition for review and reversed the order of the said Department, dated May 7, 1980, and remanded the cause for further proceedings. The Supreme Court granted a petition for writ of certiorari and by judgment dated May 31, 1983, reversed the judgment of this Court and remanded for further proceedings in conformity with its opinion. On July 20, 1983, this Court entered an order vacating its judgment entered October 31, 1981. After additional

briefing, the cause was reargued before a different panel October 26, 1983. On consideration whereof, it is now here ordered and adjudged by this Court that the within cause be, and the same, is hereby remanded to the Secretary of Education for further proceedings consistent with the opinion of this Court.

ATTEST:
/S/ SALLY MRVOS
Clerk

DECEMBER 27, 1983

Certified as a true copy and issued in lieu of a formal mandate on February 27, 1984.

Test:

Chief Deputy Clerk, U.S. Court of Appeals for the Third Circuit

APPENDIX F

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 80-1991

STATE OF NEW JERSEY,
DEPARTMENT OF EDUCATION, PETITIONER

v.

SHIRLEY HUFSTEDLER, SECRETARY OF
EDUCATION, ETC., RESPONDENT

SUR PETITION FOR REHEARING BEFORE ORIGINAL PANEL AND REHEARING IN BANC

Present: SWITZ, *Chief Judge*, ALDISERT, ADAMS, GIBBONS, HUNTER, WEIS, GARTH, HIGGINBOTHAM, SLOVITER, BECKER, *Circuit Judges*

The petition for rehearing before the original panel and before the court in banc filed by Respondent in the above-entitled case having been submitted to the judges who participated in the decision of this Court and to all other available circuit judges in the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges in the circuit in regular active service not having voted for rehearing the petition for rehearing is denied.

By the Court,

/S/ ARLIN M. ADAMS

Circuit Judge

Dated: FEB. 17, 1984